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VOLUME I

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1962

No. 70

IRVING J. WOLF, ET AL., PETITIONERS,

vs.

ARNOLD A. WEINSTEIN, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 21, 1962
CERTIORARI GRANTED APRIL 2, 1962

SUPREME COURT OF THE UNITED STATES

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[fol. 1] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

89669

In the Matter

—of—

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.

In Proceedings for the Reorganization of a Corporation

PETITION FOR REORGANIZATION UNDER CHAPTER X—
Filed September 28, 1953

To: The Honorable Judges of the District Court of the United States for the Southern District of New York:

The petition of Nazareth Fair Grounds & Farmers Market, Inc. respectfully represents:

1. Your petitioner is insolvent.

2. Your petitioner is a corporation organized and existing under the laws of the State of Pennsylvania and is a corporation which could become a bankrupt under the Act of Congress relating to Bankruptcy and is not a municipal, insurance or banking corporation, or a building and loan association, or a railroad corporation authorized to file petition under Section 77 of said Act.

3. Your petitioner by resolution of the Board of Directors maintains an office at 261 Broadway, Borough of Manhattan, City and State of New York and also has an office in Nazareth, Pennsylvania.

The plurality of the stockholders the majority of the Board of Directors and officers and the two judgment creditors as hereinafter mentioned who have precipitated the necessity for applying for the Chapter X proceeding

[fol. 2] herein are also residents of the State of New York or maintain their office and are within the territorial jurisdiction of this Court, and your petitioner has and for the past six months next preceding the filing of this petition has had its meetings of the Board of Directors and stockholders within the territorial jurisdiction of this Court. That petitioner has property and choses in action having a situs within this jurisdiction.

4. The nature of the business of your petitioner is as follows: Petitioner owns real estate popularly referred to and known as "The Nazareth Fairgrounds" located at the juncture of Routes 12 and 45 in the Town of Nazareth, State of Pennsylvania, where it maintains and operates various buildings, lands and realty which it lets or rents to concessionaires, merchants, farmers and auctioneers as tenants or licensees for the purpose of selling or auctioning their wares and produce, which land and buildings are also leased for country fairs and for automobiles races and such other legal uses as are or may be permitted by law.

5. The assets and liabilities and financial condition of your petitioner are set forth on a balance sheet annexed hereto which are based on the financial report submitted by certified Public Accountants, more particularly, Siegel, Berg & Co. and which is submitted by your petitioner in reliance of such report as prepared by the said auditors which may be summarized as follows:

(a) The assets in the main, of your petitioner which have substantial value are the land, building and improvements which according to said auditors have a book value of One Hundred One Thousand and Seventy Three ($101,073.13) and 13/100 Dollars.

[fol. 3] Petitioner estimates the value of the assets, more particularly, of the realty owned by the petitioner, at approximately the sum of One Hundred Thousand ($100,000.00) Dollars although no appraisal has been made.

The foregoing should be approximately the estimated assets of petitioner.

(b) Your petitioner verily believes that the land, building and improvements owned by your petitioner have a

greater market value than the book value as stated by the accountants who prepared such financial statement. The balance of the assets representing accounts receivable, J. Malakoff may be uncollectible and in dispute as is more specifically alleged hereafter. Similarly with the item of Three Thousand Ninety Eight ($3,098.25) and 25/100 Dollars of loans and advances; except for the realty as aforementioned balance of the assets of petitioner are negligible.

(c) The latest list as of about September 21, 1953, of the liabilities of your petitioner exclusive of its capital stock as appears on the books and records of the corporation and as submitted by the accountants as of June 30, 1953 show accounts payable in the sum of Thirteen Thousand Nine Hundred Ninety One ($13,991.65) and 65/100 Dollars which includes a note payable in the sum of One Thousand ($1,000.00) Dollars. Petitioner estimates taxes due the United States Government at approximately One Thousand ($1,000.00) Dollars. Real estate taxes due to Lower Nazareth Township, Pennsylvania, in the sum of Three Hundred Fifty ($350.00) Dollars.

Insofar as items marked "other indebtedness" where same reflects notes issued by the petitioner for Thirteen [fol. 4] Thousand Six Hundred ($13,600.00) Dollars petitioner contests such judgment notes and actions are now pending in this Court in an endeavor to stay execution of such judgment notes which ultimately resulted in a judgment by the creditors thereof, more particularly, William McK. Shongut in the sum of $10,000.00 and Benjamin Margolis for $3,600.00 further details of which are hereinafter stated. There are loans payable in the sum of Fifty Four Thousand Eight Hundred Forty Two ($54,842.92) and 92/100 Dollars, which allegedly were made by John Malakoff but which petitioner contests and for which petitioner has received a release from the said John Malakoff.

Included in the liabilities as aforementioned, are notes totalling Three Thousand Eight Hundred Sixty Six ($3,866.99) and 99/100 Dollars for insurance.

There are further obligations that petitioner has, the amounts of which are undetermined at this time including services rendered by Jerome Fried for labor approximately

one and one-half years, the Board of Directors not having fixed his remuneration which can be estimated at about One Hundred ($100.00) Dollars per week, which would be a further indebtedness of petitioner for about Seven Thousand Eight Hundred ($7,800.00) Dollars.

[fol. 5] The books reflect additional liabilities in the form of checks issued, more particularly, a check to one, N. Manochihrian for One Thousand ($1,000.00) Dollars and a note for Five Thousand ($5,000.00) Dollars to one, Seymour Forman which petitioner is contesting and has refused to pay as more specifically is explained hereafter.

The total amount of indebtedness acknowledged by petitioner is estimated at approximately the sum of Fifteen Thousand Three Hundred Forty One ($15,341.65) and 65/100 Dollars.

The foregoing is exclusive of such amounts of indebtedness as petitioner claims as meritorious defenses and offsets and exclusive of mortgages in the total sum of Fourteen Thousand Five Hundred ($14,500.00) Dollars.

That petitioner has determined from the books and records that the liabilities and estimated assets as aforementioned reflect the financial condition of petitioner as of about September 21, 1953 and that the assets and liabilities submitted substantially reflect said financial condition of petitioner.

(d) Due to the improper and illegal issuance of stock of petitioner by its former president one John Malakoff which has resulted in an action being brought in this Court in a civil part thereof, petitioner cannot fully determine all of the stock issued by petitioner and that portion of the stock that the Court might sustain as properly having been issued or not. However, according to the records of petitioner without petitioner conceding that any holder thereof is entitled to such stock except where same is subject to determination by this Court or by such other tribunal as [fol. 6] determined by this Court. It appears that there has been issued approximately Three Hundred Fifteen (315) shares of capital stock by petitioner of no par value. On knowledge and information sufficient to form a belief fifteen (15) shares were issued to one Seymour Forman as secur-

ity for a loan in dispute which stock certificates as issued are not reflected in the stock book of the corporation. Some of these shares of stock were allegedly sold at Six Hundred ($600.) Dollars per share, some were allegedly sold at One Thousand ($1,000.) Dollars per share, some as security for alleged loans in dispute, some for no consideration and some that appear to be illegally issued.

(c) The financial condition of your petitioner is fully set forth in balance sheet dated June 30, 1953 annexed hereto and made a part hereof, and the financial condition of your petitioner is substantially the same or not better than as of said date, at the present time.

6. There are no proceedings pending affecting the property of your petitioner known to it except as specified in paragraph 8 hereafter, except that one, William McK. Shongut has acquired and entered a judgment for the sum of Ten Thousand ($10,000.) Dollars in Court of Common Pleas of Northampton County, Pennsylvania, and one Benjamin Margolis has acquired a judgment in the sum of Three Thousand Six Hundred ($3,600.) Dollars in Court of Common Pleas of Northampton County, Pennsylvania. That your petitioner by order to show cause dated , made an application in this District Court for a stay of levy and execution on the judgments in question alleging that such judgments were acquired by conspiracy and fraud as more specifically stated in such order to show cause and affidavits attached and in the complaint duly served on said William McK. Shongut and Benjamin Margolis. That the Hon. Justice Edward J. Dimock rendered a decision and signed an order denying the stay or injunction as to the levy and execution under such judgments unless petitioner filed a bond in the sum of Thirteen Thousand Six [fol. 7] Hundred ($13,600.). In the event petitioner did file such bond, injunction and stay of execution would naturally be in effect. However, unfortunately, petitioner has no liquid assets and no cash whatever to furnish a bond and petitioner is not in a position to ask an insurance company or bonding company to furnish a bond in order to stay the two judgments in question.

Petitioner verily believes and has so alleged by verified complaint and corroborating affidavits and memoranda and other evidences that such judgments as acquired by William McK. Shongut and Benjamin Margolis were acquired through fraud and conspiracy. That petitioner has been unable to furnish bond. If the said William McK. Shongut and Benjamin Margolis were to levy and execute on their judgments against the realty owned by petitioner and same were sold under forced sale, the result would cause irreparable harm and damage to petitioner and to creditors and stockholders of petitioner. Same would also undoubtedly create a preferential payment to the said William McK. Shongut and Benjamin Margolis in that petitioner has not sufficient liquid funds on hand to pay all of its obligations and creditors as and when same are due.

The adoption of a suitable plan of reorganization under the said Act will protect the stockholders of your petitioner and will reduce the loss of its stockholders which would otherwise result from the enforcement of creditors' claims and consequent destruction of your petitioner's business and the values of its properties. It is essential for the protection of creditors and stockholders that levying or execution on the judgments or the commencement of suits, against your petitioner be stayed pending official decree in this proceeding.

[fol. 8] A plan of reorganization can be developed and effected so as to provide for the payment in cash of all costs of administration in this proceeding and other allowances made by the Court herein, the liquidation of all of petitioner's indebtedness and the determination of the equities of stockholders and the preservation of their rights thereby averting partial loss to its creditors and total loss to its stockholders.

7. One, Seymour Forman, by an attorney who allegedly holds a promissory note for Five Thousand ($5,000.00) Dollars allegedly executed by petitioner and also holds certain certificates has also threatened suit. Petitioner verily believes it has a meritorious defense for non-payment of the note in question. Petitioner has refused to pay such note, which note was presented for payment. Suit is impending in this matter.

8. There are proceedings pending by petitioner as represented by copy of the summons and complaint on file in this Court exhibited to this Court simultaneously with this application together with the supplemental summons and complaint which was submitted to this Court for the granting of consent to petitioner to add additional defendants and to issue such supplemental summons and complaint in substance and stating generally there have been issues raised as to fraudulent transactions and conspiracies between some of the defendants herein and petitioner's former president, John Malakoff, whereby such defendants acquired stock, judgments, moneys and/or other assets of petitioner illegally. Supplemental summons and complaint were requested in order to have all the rights of all the stockholders of petitioner determined. It appearing that [fol. 9] more stock was issued by Petitioner than that authorized by its charter and that a good portion of its stock was issued illegally and fraudulently.

9. No plan of reorganization, readjustment, or liquidation affecting the property of your petitioner is pending either in action with or without any judicial proceeding, except as stated in paragraph "6" hereof.

10. The specific facts showing the need for relief under Chapter X of said Act are as follows: The estimated and approximate value of the assets of your petitioner which consist in the main of its realty holdings, petitioner would estimate at a value of One Hundred Thousand ($100,000.) Dollars the mortgages total, as of June 30, 1953, Fourteen Thousand Five Hundred ($14,500.) Dollars. Petitioner is in no position financially to presently meet all of its just liabilities and indebtednesses due because it is not in a liquid position and has not the cash available to meet same. The liabilities due exclusive of mortgages and notes are as hereinbefore mentioned. Petitioner is also unable due to its cash position and financial condition to deposit Thirteen Thousand Six Hundred ($13,600.) Dollars in order to get a continuance of the stay of the judgments fraudulently and illegally obtained against petitioner and which petitioner is contesting. Similarly, with the note executed to Seymour Forman for Five Thousand ($5,000.) Dollars

which also is in dispute, taking into consideration that petitioner's assets are fixed and frozen assets consisting of realty and in view of the liabilities aforementioned, the valid ones which are due and cannot be met, and in view of the general financial condition as heretofore submitted, petitioner needs relief under Chapter X in addition to the fact that stockholders' reorganization is necessary and their rights have to be determined. It would, therefore, appear that exclusive of the issued stock to sundry stockholders of petitioner, the legal ownership of which petitioner is not in a position to determine and your petitioner is contesting, as hereinbefore set forth and as specifically [fol. 10] set forth in the copy of summons and complaint exhibited to this Court together with copy of supplemental summons and complaint for which an order has not been signed to be issued. It would appear that the net assets of the corporation are such as would be sufficient to pay its liabilities. However, petitioner is unable to determine the true value of petitioner in that petitioner cannot determine the legality and propriety of the stock issued by petitioner illegally and fraudulently through its former president, John Malakoff, in conspiracy with others who will be brought into this proceeding and who already have been brought into a civil proceeding in this Court. Petitioner is also unable to pay its creditors in that petitioner has not the liquid cash on hand. Petitioner is also unable to furnish a bond in the sum of Thirteen Thousand Six Hundred ($13,600.00) Dollars in order to stay the execution and levy on judgments acquired fraudulently, as claimed by petitioner, by Margolis and Shongut and, in the event of a levy or forced sale or multiplicity of suits by the authorized alleged stockholders, claimants or creditors, the result of the aforementioned, inclusive of possible actions by stockholders against the corporation for moneys given to the former president, John Malakoff, would result in irreparable damage and harm to petitioner, might bring substantially less than necessary to pay petitioner's liabilities and would cause an interference and destruction in the business and property of petitioner. It would further inevitably result in loss to creditors and destruction of the rights of stockholders that this Court might determine are

legally entitled to ownership of such stock. Your petitioner [fol. 11] operates its business in Nazareth, Pennsylvania and has a great amount of good will and requires the good will of its patrons and farmers in that area and in the event there would be any levy and execution on the realty by the judgment creditors, and the business operations of petitioner would stop for any period of time, its customers who rent stalls or space in the buildings maintained by your petitioner, might seek other areas or other space for rental, to the impairment of petitioner's business.

The specific facts showing why adequate relief cannot be obtained under Chapter XI of said Act are as follows: Your petitioner cannot be reorganized with reasonable prospect of success in the continued operation of its business merely by an arrangement with its unsecured creditors due to the allegedly illegal and unauthorized or fraudulent stock issued by petitioner there has to be a determination as to the equities and the rights as to the present stock interests and a recasting of present stock interests and an alteration, modification or nullification of the rights of the unsecured creditors some of whose claims are in dispute and possibly new capital may be necessary all part of a single plan of reorganization.

11. Your petitioner desires that a plan of reorganization be effected for it under and pursuant to Chapter X of said Act.

12. That as previously stated, petitioner is engaged in the business of renting stands and space to farmers and others, that there has been personal contact between Jerome Fried and the people in the immediate vicinity who [fol. 12] rent such space and in some instances daily, weekly and/or monthly, and that there is a great amount of good will between the said Jerome Fried and the licencees. That Arnold A. Weinstein, Esq., attorney, of 261 Broadway, in the Borough of Manhattan, City and State of New York, is president of the petitioner and has been active in the operations and conduct of the business and aiding and supervising same. That it is necessary and essential for the conduct of petitioner's business that the said Jerome Fried and Arnold A. Weinstein continue in the capacity that they

have heretofore been in and render services on behalf of petitioner during the proceeding herein. That the fair and reasonable value of the services to be rendered by the said Jerome Fried and the said Arnold A. Weinstein, would be at the rate of One Hundred ($100.00) Dollars per week each for the work, labor and services to be rendered by them, Arnold A. Weinstein, however, for the purposes of aiding the reorganization of the corporation, will draw no salary. The said Jerome Fried is at all times on the premises of petitioner and physically and actively attending to the business of petitioner and the said Arnold A. Weinstein supervising the conduct of the operation of the business, signing checks, watching the income, negotiating contracts or leases. That Arnold A. Weinstein is president of petitioner and a director, and that the other officers are: Charles Kanter, Vice-President and H. Lawrence Lopheimer, Secretary-Treasurer. That petitioner does a business of approximately Fifty Eight Thousand ($58,000.00) Dollars annually and the operating expenses exclusive of improvements on buildings and realty would be estimated at about Forty Three Thousand ($43,000.00) Dollars, leaving a net profit annually of approximately Fourteen Thou- [fol. 13] sand ($14,000.00) Dollars. That petitioner estimates that the income for the next thirty (30) days would be just under Five Thousand ($5,000.00) Dollars and that the operating expenses would be approximately Four Thousand ($4,000.00) Dollars, which operating expenses will include the wages and salary of Mr. Jerome Fried and all other incidental carrying charges such as advertising, heat, light and power, market supplies, garbage removal, insurance, interest, office expense, taxes, telephone and any other nominal incidental expense.

That there is no doubt that the petitioner can and will operate profitably during such time as petitioner is allowed to continue in possession.

Changing the personnel or the operations of business would impair the good will which is an important segment of petitioner's business. That in view of the fact that the amount due general creditors or all creditors exclusive of the capital stock issued, is only Fifteen Thousand Three Hundred Forty One ($15,341.65) and 65/100 Dollars, ex-

clusive of amounts in dispute as aforementioned, exclusive of the litigated matters and in that the operations of the business are of a personalized nature as hereinbefore mentioned, petitioner respectfully requests that the Honorable Court authorize petitioner to continue operations of the business by its officers, Arnold A. Weinstein and its operating manager, Jérome Fried.

Petitioner further requests that this Honorable Court grant leave to petitioner to pay its creditors as and when the bills become due and that petitioner knows it will operate at a profit and does not want to destroy the good will of petitioner in the area where it conducts its business.

It is petitioner's intention and petitioner will be able to pay to all creditors One Hundred (100) Cents on the Dollar, except that petitioner will contest claims of certain [fol. 14] creditors where petitioner feels it has an honest and meritorious defense and/or offset.

13. No other petition by or against your petitioner is pending under Chapter X of said Act, nor is any other bankruptcy proceeding, initiated by a petition by or against your petitioner, now pending.

Wherefore, your petitioner prays

(a) That an order be entered approving this petition.

(b) That petitioner shall continue in possession of its property and shall have all the right, title in the exercise consistently with the provisions of Chapter X of the Bankruptcy Act, all the powers of a trustee appointed pursuant to Section 44 of the Act of Congress relating to Bankruptcy.

(c) That petitioner be vested with the rights and powers of a receiver in equity appointed by the Court of the United States for petitioner's property, except such rights and powers as may be inconsistent with the provisions of Chapter X of said Act and subject, however, at all times to the control of the Court and to such limitations, restrictions, terms and conditions as the Court may from time to time prescribe.

(d) That such petitioner by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to

operate the business and manage the property of your petitioner.

(e) That such further proceedings may be had upon this petition in accordance with the provisions of Chapter X [fol. 15] of said Act and that your petitioner have such other and further relief as is just.

Nazareth Fair Grounds & Farmers Market, Inc.,

By Arnold A. Weinstein—Pres.

Alex L. Rosen, Attorney for Petitioner, 225 Broadway, New York 7, New York.

Duly sworn to by Arnold A. Weinstein, jurat omitted in printing.

[fol. 16]

ATTACHMENT TO PETITION

Nazareth Fair Grounds & Farmers Market, Inc.

BALANCE SHEET
June 30, 1953

ASSETS

CURRENT				
Cash on hand			$ 70.25	
Accounts Receivable—J. Malakoff			11,811.78	
Unexpired Insurance			1,522.54	$ 13,404.57
PROPERTY AND EQUIPMENT				
	Cost	Acc. Dep'n	Adj. Cost	
Land	$ 6,000.00		$ 6,000.00	
Buildings	70,543.50	$6,050.11	64,493.39	
Improvements	24,529.63	2,374.70	22,154.93	
	$101,073.13	$8,424.81		92,648.32
OTHER ASSETS				
Loans and Advances (Schedule A-1)			$ 3,798.25	
Deposits			50.00	
Organization Expense			349.65	4,197.90
TOTAL ASSETS				$110,250.79

LIABILITIES AND CAPITAL

CURRENT LIABILITIES		
Cash in bank—Overdraft	301.33	
Accrued and Withheld Taxes	278.39	
Accounts Payable	9,934.87	
Accrued Payroll	253.50	
Notes Payable—		
J. Sherman (Due 8/20/53)	1,000.00	$ 11,768.09

Other Indebtedness		
First Mortgage Payable (Due 10/10/53)	$ 8,500.00	
Second Mortgage Payable (Due 4/17/56)	6,000.00	
Notes Payable—Insurance	1,220.00	
Loans Payable (See Schedule)	1,795.72	
Judgment Notes Payable	13,600.00	
Loans Payable	54,842.92	85,958.64
Reserve for Federal and State Income Taxes		3,674.69
Capital and Surplus		
Capital Stock issued—Common	$ 1,500.00	
Surplus (Schedule A-3)	7,349.37	8,849.37
Total Liabilities and Capital		$110,250.79

[fol. 17] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

In Proceedings for the Reorganization of a Corporation

#89669

In the Matter

—of—

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.

ORDER APPROVING PETITION—September 28, 1953

This cause having come on to be heard on the petition of Nazareth Fair Grounds & Farmers Market, Inc. the above named debtor, verified September 25th, 1953, praying that proceedings be had under Chapter X of the Act of Congress relating to Bankruptcy and it appearing that no notice of said hearing should be given, and after hearing Alex L. Rosen, Esq. attorney for the said debtor, in favor of said petition, and there having been no other appearances,

Now, upon the said petition of all the proceedings had before me at the said hearing, and the affidavit, together with six copies thereof, required by Bankruptcy Rule X-4 of this Court having been submitted, and due deliberation having been had thereon, the Court is satisfied and does find (1) that the petition of Nazareth Fair Grounds & Farmers Market, Inc. the above named debtor, verified September 25th, 1953, praying that proceedings be had under Chapter X of the Act of Congress relating to Bankruptcy, complies with the requirements of said Chapter X, and (2) that said petition has been filed in good faith; and it is

Ordered, that said petition be and it hereby is approved.

Dated: New York, New York, September 28, 1953.

Alexander Holtzoff, United States District Judge.

[fol. 18] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

#89669

In the Matter

—of—

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC., Debtor.

ORDER AUTHORIZING DEBTOR IN POSSESSION TO OPERATE BUSINESS, ETC.—September 28, 1953

At New York City, in said District, on the 28th day of September, 1953.

Upon the petition of Nazareth Fair Grounds & Farmers Market, Inc., duly verified the 25th day of September, 1953, praying that it be authorized to file a Chapter X proceeding under the Bankruptcy Act and that it be authorized to operate its business and manage its property and for such relief as therein set forth, and it appearing that no notice of a hearing thereon should be given and no adverse interest having been represented, and there having been no other appearances, and sufficient reason appearing to me therefor, it is

Now, upon said petition of all the proceedings had before me at the said hearing and the affidavit together with six copies thereof required by Bankruptcy Rule X-4 of this Court having been submitted, it is

Ordered, that the debtor in possession be and it hereby is, authorized to operate its business and manage its property pursuant to Sec. 343 of the Bankruptcy Act, until the further order of the Court, and it is further

Ordered, that the debtor in possession shall close the present books of account as of the close of business this [fol. 19] day, and shall open new books of account as of the

opening of business tomorrow, in which new books of account it shall cause to be kept proper accounts of its earnings, expenses, receipts, disbursements and all obligations incurred and transactions had in the operation of the business and the management, preservation and protection of the property of the within estate, and said debtor in possession shall preserve proper vouchers for all payments made on account of such disbursements, and it is further

Ordered, that the Nazareth Fair Grounds & Farmers Market, Inc. shall continue in possession of its property and shall have all the right and title in the exercise consistently with provisions of Chapter X of the Act, all the powers of a trustee appointed pursuant to Section 44 of said Act subject to however, at all times, the control of the Court and to such limitations, restrictions, terms and conditions as the Court may from time to time prescribe and pursuant to such limitations, restrictions and terms as are consistent with Chapter X of the Bankruptcy Act, and it is further

Ordered, that subject to the further order of the Court the said Nazareth Fair Grounds & Farmers Market, Inc. be and the same is hereby authorized to pay One Hundred ($100.00) Dollars weekly to Jerome Fried, its secretary-treasurer, and no salary to Arnold A. Weinstein, who for the purposes of aiding the reorganization of the corporation, will draw no salary, and it is further

Ordered, that the debtor in possession be, and it hereby is, authorized to pay their employees, other than officers and directors, salaries earned by them, and it is further

[fol. 20] Ordered, that during such operation and management said debtor in possession shall file, in duplicate, the following:

A verified monthly report not later than the day of each month which shall set forth a summary of the operations of the business during the preceding month and a verified statement of:

a) Receipts, from all sources, classified and balance on hand at the beginning and at the end of the month;

b) Disbursements for all purposes, classified; and

c) The amount of indebtedness incurred and remaining unpaid and contractual and other obligations assumed;

and it is further

Ordered, that the debtor in possession be, and it hereby is required to comply with Rule XI-5, Subd. 1, which requires:

A verified weekly statement of cash receipts and disbursements, setting forth the names of the persons to whom payments have been made, the amounts of the payments, the amounts of the deductions for withholding and social security taxes and whether or not such deductions have been deposited in a special account;

and the requirements of Rule XI-5, Subd. 2(d) which requires:

detailed inventory on hand at the beginning of the month and detailed inventory on hand at the end of the month;

and it is further

Ordered, that the debtor in possession shall not sell any of its assets except during the regular course of business and not less than cost and shall not hypothecate any of its assets without an order of this Court; and it is further

Ordered, that all moneys received by the debtor in possession are to be deposited in National City Bank and Trust [fol. 21] Co. of New York and to be withdrawn by checks signed by:

Arnold A. Weinstein, President and countersigned by John E. Joyce, Esq. one of the Referees in Bankruptcy

and it is further

Ordered, that Nazareth National Bank & Trust Co. located in Nazareth, Pennsylvania be and hereby is, directed to transfer to the account of Nazareth Fair Grounds & Farmers Market, Inc., debtor in possession, all moneys now on deposit in the name of Nazareth Fair Grounds & Farmers Market, Inc., whether special or regular accounts; and it is further

Ordered, that the debtor in possession, Nazareth Fair Grounds & Farmers Market, Inc., is hereby directed and required to segregate and hold separate and apart from all other funds all moneys withheld from employees or collected from others for taxes under any law of the United States or of any State or subdivision thereof, and to deposit the moneys so withheld or collected in a separate designated depository bank account, not later than within the calendar week next after such collecting or withholding. The debtor in possession shall retain such funds in such separate bank accounts pending further order of this Court, except that from said bank account to the appropriate authorities, the appropriate amounts at the times and in the manner prescribed by law; and it is further

Ordered, that at the time of making such deposit of money in a separate bank account pursuant to this order, that debtor in possession aforesaid shall notify the Direc- [fol. 22] tor of Internal Revenue for the attention of the Legal Section, of the date and place of deposit, and the amount of money deposited with respect to each item of Federal Tax upon the form furnished by the Director of Internal Revenue.

Alexander Holtzoff, United States District Judge.

[fol. 23] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

In Proceedings for the Reorganization of a Corporation

#89669

ORDER TO RESTRAIN CREDITORS FROM PROCEEDING WITH ACTIONS—September 28, 1953

At New York City in the said District, on the 28th day of September, 1953

Upon reading and filing the petition of the debtor herein duly verified the 28th day of September, 1953, and sufficient cause herein appearing, it is

Now, on motion of Alex L. Rosen, attorney for the petitioner,

Ordered, that all persons, firms and corporations, including all creditors of said petitioner and the representatives, agents, attorneys and servants of all such creditors, and all sheriffs, marshals and other officers and their deputies, representatives, and servants, are hereby jointly and severally, enjoined, restrained and stayed from removing, transferring, disposing of, or attempting in any way to remove, transfer or dispose of, or in any way interfere with any of the property, assets or effects in the possession of said petitioner or owned by the said petitioner, and in possession of any officers, agents, attorneys or representatives of said petitioner, and all said persons are further enjoined, stayed and restrained from executing or issuing or causing the execution or issuance or the suing out of any court of any writ, process, summons, attachment, replevin, execution or any other proceedings for the purpose of impounding or taking possession of or interference with any [fol. 24] property owned by or in the possession of the

said petitioner and in the possession of any agents, servants or attorney of said petitioner and each and all of said persons, firms or corporations having process against the petitioner are hereby jointly and severally restrained, stayed and enjoined from taking any steps, measures or proceedings or doing any act or thing in any action wherein the said petitioner may be either plaintiff, defendant, petitioner or respondent and from causing, procuring, suffering or permitting the same to be done, other than suits to enforce liens upon the property of the petitioner; and it is further

Ordered, that all persons, firms and corporations be, and they hereby are, enjoined from disturbing or interfering with gas, telephone service, heat, electrical service, water supply, or any other utility of like kind furnished to said petitioner, and are hereby enjoined from cutting off or disconnecting the furnishing of any such utilities to said petitioner until further order of this Court.

Alexander Holtzoff, U.S.D.J.

[fol. 25] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

ORDER APPROVING COMPENSATION, ETC.—April 28, 1955

At New York City in said District on the 28th day of April, 1955.

Debtor in Possession having duly brought on for hearing before this Court on the 20th day of April, 1955, a petition and motion to authorize the Debtor in Possession to pay the sum of $150.00 per week to Jerome Fried as and for services to be rendered by him as general manager in charge of operations of Debtor in Possession, and the sum of $50.00 per week to Arnold A. Weinstein for services to be rendered by him,

Now, upon reading and filing the order to show cause herein made on the 12th day of April, 1955 by the undersigned District Judge, the petition of the Debtor in Possession, by Arnold A. Weinstein, duly sworn to the 11th day of April, 1955 and the affidavit of service of Anna E. Luby of the notice of hearing mailed pursuant to the order of this Court, sworn to the 15th day of April, 1955, all in support of said motion, and upon reading and filing the affidavit in opposition of Benjamin Margolis, on his behalf and as attorney for Ida Mae Margolis and Sarah Kason, sworn to the 19th day of April, 1955, in opposition to said motion, and after hearing Alex L. Rosen, Esq., attorney for the Debtor in Possession, in favor of said application and Benjamin Margolis, in opposition thereto, it is

[fol. 26] Ordered that the petition of the Debtor in Possession be and the same is hereby granted as follows:

That the Debtor in Possession be and the same is hereby authorized to pay Jerome Fried, commencing with the 1st day of May, 1955, the sum of $150.00 per week as and for the services to be rendered by the said Jerome Fried for and on behalf of the Debtor in Possession as general manager in charge of operation of the business operated by the Debtor in Position, and it is further

Ordered that the decision of this Court be reserved on the application of the Debtor in Possession for the payment of $50.00 per week for the services to be rendered by Arnold A. Weinstein, to the Debtor in Possession.

Sidney Sugarman, U.S.D.J.

[fol. 27]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter of

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.

Debtor in Possession

ORDER TO ALLOW COMPENSATION FOR OFFICER-EMPLOYEE OF DEBTOR—May 19, 1955

The petition of the debtor in possession to approve the resolution of its Board of Directors passed on April 5, 1955 to pay to Arnold Weinstein, President, the sum of $50.00 per week for services to be rendered from that date and subject to modification by the court while the reorganization is pending, is granted.

It appears that the sum authorized by the Board of Directors to be paid for the services set forth in Weinstein's affidavit dated April 11, 1955 is fair and reasonable. Bankruptcy Act §191.

Settle order.

Dated: May 19, 1955
New York, New York

Sidney Sugarman, United States District Judge.

Memo. Endorsed

[fol. 28] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 89669—1953

[Title omitted]

ORDER TO SHOW CAUSE—December 28, 1955

At New York in said District on the 28th day of December, 1955.

Upon the annexed petition of the Debtor in Possession by Arnold A. Weinstein, its president, duly sworn to the 27th day of December, 1955, upon the affidavit of Jerome Fried, Manager of the Debtor in Possession, sworn to the 24th day of December, 1955 and upon all the proceedings had herein,

Ordered that all claimants who have heretofore filed claims in the above proceeding show cause at a term of this Court to be held on the 12th day of January, 1956 at 10:30 o'clock in the forenoon, or as soon thereafter as counsel can be heard in Room 2804 United States Court House, Foley Square, Borough of Manhattan, City and State of New York, as to why the following orders should not be granted and why the petitioner should not be granted the following relief:

1. Authorizing additional expenditures to be made and already incurred by the Debtor in the sum of $6641.41.

2. Granting leave to the Debtor in Possession to compromise and settle the claim against the State of Pennsylvania for condemnation of approximately one-third of an acre owned by the Debtor in Possession for the sum of $8000.

3. Granting leave to the Debtor in Possession to increase the salary paid to Jerome Fried for acting as Manager of the Debtor in Possession from the sum of $150.00 to the sum of $200.00 per week.

[fol. 29] 4. Granting leave to the Debtor in Possession to finance a five year payment of insurance premiums. And for such other and further relief as may be just in the premises and as demanded in the petition, and it is further

Ordered that the Debtor in Possession may serve notice of the application herein, a copy of which notice is hereto attached, by mail, to be forwarded to all claimants who have filed claims heretofore in this proceeding on or before the 30th day of December, 1955 and that the mailing of such notice shall be deemed proper and sufficient service thereof.

Sidney Sugarman, U.S.D.J.

[fol. 30]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

PETITION OF ARNOLD A. WEINSTEIN

To the Honorable Judge Sidney Sugarman, Judge of the United States District Court for the Southern District of New York:

The petition of Nazareth Fair Grounds & Farmers Market, Inc., Debtor in Possession, by Arnold A. Weinstein, its President, respectfully shows:

Additional Cost of Construction

1—That heretofore and on the 4th day of January, 1955, this Court signed an order permitting the Debtor in Possession to construct a building connecting two of the existing structures on the premises of the Debtor in Possession in Nazareth, Pennsylvania.

2—That pursuant to the aforesaid order, the Debtor in Possession was authorized to expend the sum of $26,000.00 for the construction purpose aforesaid; that the total cost of the newly constructed building was $32,641.41.

3—That the construction cost of the aforesaid building entailed additional expense of $6,729.58 which was not anticipated.

4—That the aforesaid increase was occasioned by a demand for space by additional tenants during the course of construction which entailed making the building larger than originally planned. Petitioner had no time because of the [fol. 31] circumstances to apply for further leave of the Court. There were also unanticipated materials and labor costs as more specifically set forth in the affidavit of Jerome Fried which is annexed hereto and made part of this petition.

5—That the new building contains approximately 21,000 square feet as against approximately 18,500 square feet contemplated under the previous order of this Court. Despite the unanticipated expense, the construction cost of the building breaks down to approximately $1.50 per square foot which was the estimated cost previously presented to the Court.

6—That the new building is fully rented and the following is the monthly rent roll thereof:

Leslie Drugs	$ 250.
Phillipsburg Grocer	$ 275.
Dress Store	$ 125.
Army & Navy Store	$ 150.
Wanko	$ 80.
Mink	$ 80.
Champion Sales	$ 80.
Herman	$ 40.
Bentz	$ 43.
Homeward Step	$ 32.
Kornfield	$ 40.
Joyce	$ 40.
Stever & Achey	$ 212.
Zimanski	$ 20.
Klein	$ 173.
DeCarlo	$ 85.
Average Transients	$ 80.
Average Concession percentage	$ 100.
	$1905.

7—That by reason of the foregoing, the annual rent roll of the new building is $22,860.00; that the ground upon which the new building stands previously brought in rents of approximately $3,000.00 per year leaving the sum of $19,860.00 as additional yearly rental actually being received by the Debtor in Possession as a result of the new construction.

[fol. 32] Condemnation

8—Heretofore, and prior to this Chapter X, proceeding, the State of Pennsylvania condemned a portion of the Debtor's property fronting Pennsylvania Route #12 for the purpose of widening the highway. The condemned strip was approximately 15 feet deep by 1,000 feet in length running along the highway.

9—For the purpose of ascertaining the value of this property, the Debtor applied to this Court for the appointment of an appraiser so that it could be guided in making an adjustment of its claim against the State of Pennsylvania. One J. M. Brandau, an appraiser from Easton, Pennsylvania was so designated. Mr. Brandau submitted an appraisal of $20,000.00 for the condemned strip. This appraisal was submitted to the Local Highway Officials in Pennsylvania who disagreed with it and submitted their own appraisal of $3,000.00 which was offered in settlement of the matter.

10—The $3,000.00 offer by the State of Pennsylvania was submitted to the Board of Directors of the Debtor and was refused. Thereafter, Alex L. Rosen, Esq. attempted to litigate the matter in this Court rather than proceed with a cumbersome and time consuming procedure in the Courts of Pennsylvania. With this in mind, a counterclaim for $20,000.00 was interposed by the Debtor against the Tax Claim filed in this reorganization proceeding by the State of Pennsylvania. Thereafter, Mr. Rosen and your petitioner were referred to the Attorney General of the State of Pennsylvania, who in turn referred the matter to the State Highway Superintendent. A conference was had in the State Capital in Harrisburg which was attended by

Mr. Rosen and Arnold A. Weinstein, after which the matter was resubmitted to the Local Officials by the Highway Su-
[fol. 33] perintendent. A further conference was thereafter held at the premises of the Debtor at which the condemned strip was examined and visually surveyed. An offer was then submitted by the State of Pennsylvania in the sum of $5,000.00. This offer was refused and a further and final offer of $8,000.00 was made.

11—The offer of $8,000.00 has been considered by the Debtor's Board of Directors and has been found to be acceptable subject to the approval of this Court.

12—It is felt that the $8,000.00 should be accepted despite the appraisal of $20,000.00 submitted by Mr. Brandau. It is to be borne in mind that the Debtor still has its original frontage along the highway and there has been no cut off or obstacle to the Debtor as to such highway. The only difference is that the property line has been pushed back some 15 feet. It appears that the rule in Pennsylvania on condemnation is to pay the difference between the market value before and after the taking. In view of the fact that the premises of the Debtor consists of approximately 31 acres, the land of which has been valued by Mr. Brandau at $100,000.00, it is difficult to understand how the taking of 15,000 square feet equal to one-third of an acre, can reduce the market value by $20,000.00 leaving a present value of $80,000.00 for the land.

13—Another reason for accepting the offer of $8,000.00 is the problem presented in litigating the condemnation in this Court. Whether this Court has jurisdiction to try the Debtor's counterclaim is a matter of first impression and, if pursued, may be taken to the Supreme Court of the United States by the State of Pennsylvania. This will delay the winding up of the reorganization proceeding. On the other hand, even if the Debtor should pursue its remedy in
[fol. 34] the first instance by applying to the State Courts of Pennsylvania, it will be at least two years before the matter can be disposed of; so that in either event an inordinate amount of time will be spent in the matter and the reorganization will be held up pending this resolution.

14—Furthermore, local counsel will have to be retained for the purpose of litigating the condemnation. Fees in such matters range from 25 per cent. to 40 per cent. on a contingency basis. The judgment in litigation might be even less than the $8,000.00 offered. Under all of the circumstances, the ultimate result in litigation might equal, or even be less than, the $8,000.00 offered by the State of Pennsylvania and, to boot, the Debtor will have been delayed in reorganization to its obvious damage.

It is respectfully requested that leave to compromise the aforesaid condemnation claim in the sum of $8,000.00 be authorized to the end that the best interests of the Debtor will thereby be served and to the further end that the assets of the Debtor will be conserved.

Increase in Salary for General Manager

15—When the petition for reorganization was first presented, the Debtor had Jerome Fried in its employ as general manager. Upon entertaining the petition the Honorable Justice Alexander Holtzoff fixed the salary payable to Mr. Fried at $100.00 per week. Thereafter, by order of this Court dated April 28th, 1955, the salary payable to Mr. Fried was raised to $150.00 per week in line with a resolution of the Debtor's Board of Directors, dated April 4th, 1955, made subject to the approval of the Court.

[fol. 35] 16—The resolution also recited that in the event the Debtor's income, viewed after the ensuing four months' operations, rose to $85,000.00 annually, then the Debtor in Possession would apply to this Court for an increase of $50.00 in the salary payable to Mr. Fried.

17—It appears that the Debtor is presently operating at a gross income rate of more than $85,000.00 annually. This is to be compared with a gross of $63,371.50 for the fiscal year 1954-1955. The increased income is due in greater part to the income resulting from the new building at the Market.

18—Mr. Fried has continued to render the services set out in the petition addressed to this Court under date of

April 11th, 1955. Moreover, it must be recognized that because of his excellent services in handling and supervising construction, the new building cost at least $20,000.00 less than would have had to be paid to a general contractor. In a sense, therefore, Mr. Fried has more than earned the increase in salary for which application is hereby made. Moreover, based upon the caliber and amount of services he renders, Mr. Fried is deserving of the $50.00 weekly increase in his salary.

Mr. Fried had expressed his willingness for a limited time to accept the aforesaid $150.00 as his weekly salary in the hope that this Chapter X. proceeding would be speedily terminated. However, because of delays in this proceeding which were not caused by the Debtor, it appears that the proceeding may take a considerable time in addition to the time already spent in reorganizing the Debtor. The Debtor is in need of the services of Mr. Fried who refused to continue as general manager on his present rate of compensation. The Debtor cannot replace this manager [fol. 36] who has established excellent personal relations with the numerous tenants at the premises of the Debtor and who has experience with the local conditions which prevail at the Market.

It is important for the purpose of conserving the assets of the Debtor including the maintenance of the good-will which has been established that Mr. Fried's salary be raised by the sum of $50.00 per week. The approval of this increase in salary would be in the best interests of the Debtor.

Insurance Financing

19—The Debtor in Possession is desirous of obtaining coverage under the following insurance policies each of which is for a term of 5 years, except the last three liability policies which are for one year:

F 1229947	American Automobile	Bldgs. (fire)	3,300.	265.00
4490911	The Home Ins. Co.	Bldg.—Fire & EC	2,500.	140.00
M 437059	World Fire & Marine	Bldg.—Fire & EC	2,500.	140.00
207506	Ins. Co. of North Am.	" " " "	7,500.	426.00
317753	North River Ins.	" " " "	2,500.	140.00
73-662	Globe & Republic	" " " "	7,500.	912.00
CAM 8002F	Underwriters at London	Fire & Lighting EC	72,000.	5212.80
AL 5123 F	" " "	Rents Form	20,000.	796.40
22 86 30	Rochester-American	Bldg.—Fire & EC	2,500.	140.00
41190	C. E. Heath & Co. Ltd.	Fire & EC	50,000.	2800.00

Total Premium	$10,966.80
Interest	877.20
Balance Due	$11,844.00

Down Payment	$2,220.75	Due December 31
(39) Payments	246.75	Due Monthly thereafter

[fol. 37]

C 79827	Newhouse & Hawley	O.L.&T	B.I. 15/30 Excess 5/10,000 P.D. 5000.00	$360.50
C 763582	Newhouse & Hawley	O.L.&T	Excess OLT 30/60 Publ. Liab. 20/40	$180.25
C 763561	Newhouse & Hawley	O.L.&T	B.I. 5/10,000 P.D. 5000.00	$772.50

Total premium	$1313.25	
Interest	23.15	
	$1336.40	
Down payment	$834.25	due December 31
(3) payments	167.05	due monthly thereafter

20—It is possible to save a considerable sum of money, equal to the premiums for one year, by taking the policies out for a five year term rather than for one year. This may be done by financing the payment of premiums on the forms and in the manner required by the Carriers in question.

21—The insurance hereinabove set forth is necessary for the protection of the Debtor and request is hereby made for leave to finance the premiums therefor upon the Debtor's undertaking to pay the same as set forth in the schedules above.

• • • • • • •

22—All of the relief requested herein is in the best interests of the Debtor.

23—That no previous application has heretofore been made for the relief requested herein except as may have been hereinabove set forth.

Wherefore, petitioner respectfully prays for an order:

[fol. 38] 1) Authorizing the expenditure of a total sum of $32,641.41 on account of the newly constructed building on the premises of the Debtor in Possession,

2) Granting leave to compromise for $8,000.00 the condemnation claim held by the Debtor in Possession against the State of Pennsylvania,

3) Granting leave to increase by $50.00 weekly salary payable to Jerome Fried,

4) Granting leave to the Debtor in Possession to finance the aforesaid insurance policies over a Five year period.

Dated, New York, December 27, 1955.

Nazareth Fair Grounds & Farmers Market, Inc.,

By Arnold A. Weinstein, President.

[fol. 39]
State of New York,
County of New York, ss.

Arnold A. Weinstein being duly sworn, deposes and says, that he is the President of Nazareth Fair Grounds & Farmers Market, Inc., the corporation named in the within entitled action; that he has read the foregoing petition and knows the contents thereof, and that the same is true to his own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters he believes it to be true.

Deponent further says that the reason this verification is made by deponent and not by Nazareth Fair Grounds & Farmers Market, Inc. is because said Debtor in Possession

is a corporation and deponent is an officer thereof, to wit, its President.

Arnold A. Weinstein

Sworn to before me this 27th day of December 1955.

Marvin N. Rosen, Notary Public, State of New York, No. 31-3348685, Qualified in New York County, Term expires March 30, 1957.

[fol. 40]

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In Proceedings for a Reorganization

In the Matter of

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.,

Debtor in Possession.

State of New York,
County of New York, ss.:

Arnold A. Weinstein, being duly sworn, deposes and says:

That the Debtor-in Possession has not made application for the relief herein demanded and that the matter herein is being brought on by Order to Show Cause in lieu of Notice of Motion, in that there are some creditors to whom there are monies due for credit extended in the additional construction made by the Debtor in Possession on the premises owned and constructed by the Debtor in Possession and in that an arrangement is to be made as expeditiously as possible for the payment of the five year premiums as applied for.

Arnold A. Weinstein

Sworn to before me this 27th day of December, 1955.

Marvin N. Rosen, Notary Public, State of New York, No. 31-3348685, Qualified in New York County, Term expires March 30, 1957.

[fol. 41]

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter of

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.,

Debtor in Possession.

AFFIDAVIT OF JEROME FRIED

State of Pennsylvania,
County of Northampton, ss.

Jerome Fried being duly sworn deposes and says:

I am the Manager of Nazareth Fair Grounds and Farmers Market, Inc., the Debtor in Possession herein.

I have superintended the construction of the newly erected building on the premises of the Debtor in Nazareth, Pennsylvania and make this affidavit in support of the foregoing petition and in explanation of the increased costs entailed in its construction.

During the course of the construction of the new building, I received requests for space therein which was in addition to the Tenants who had previously agreed to take space. Because of this, the building was constructed approximately 2500 square feet larger than had originally been planned and consequently added to the cost of construction.

Other matters also added to the total cost. The original estimate for the construction of the new building was made in October, 1954. It was anticipated that actual construction could be started on or about December 1st, 1954 when the weather was not too cold and the ground not frozen. Moreover, it was anticipated that ground fill could be ob-

tained without cost to the Debtor. However, obtaining [fol. 42] Court approval for the construction was delayed until January, 1955 by reason of the opposition of certain stockholders, with the result that when actual construction started the weather had turned cold, the ground froze and free fill was not then available, all of which caused an increase in the cost of construction.

The increased construction costs are broken down as follows:

Ground fill:	At the time construction was authorized this fill was no longer available without charge and the cost thereof was—	$1301.00
Compressor and Steam Shovel:	For use in breaking up frozen ground at a cost of—	120.25
Additional Cement:	Because it is impossible to cut a fine trench in frozen ground, trench digging resulted in a larger area into which the cement was poured. The additional cost was—	1000.00
Calcium:	Was mixed with the cement by reason of the cold weather at a cost of—	170.00
Labor:	The productivity of labor was reduced by the cold weather. For example the driving of special nails into the lumber was necessary because the wood was frozen. In addition the overall output of labor in all building operations was lessened. The additional cost was—	1433.33
Fans:	Despite the many doors and entranceways in the building, it was found necessary to install 3 large roof fans for proper building ventilation. The cost was—	705.00

[fol. 43]

Toilets:	During the course of construction the prospective tenants of the new building demanded that toilets be made available to them and to their help before they would take possession. It was necessary to put in 5 toilets at a cost of—	$2000.00
		$6729.58

I may say that even though the new building has cost more than anticipated, the overall cost thereof is only $1.50 per square foot which is remarkably low in these times for a well constructed building. The Court is respectfully advised that the insurance appraisals of the replacement cost of the new building shows a value of $65,000.00 which has been the figure set by the Insurance Companies as their estimate for the value of the building in question.

Wherefore I respectfully join in the prayer of the petition that the sum of $32,641.41 be authorized for the payment of the construction costs of the building, inclusive of the sum of $26,000.00 heretofore authorized for that purpose.

Jerome Fried

Sworn to before me this 24th day of December 1955.

Chas. E. Knecht, J.P., Justice of the Peace. My Commission expires 1st Mon. in Jan. 1956.

[SEAL]

[fol. 44]

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re: Nazareth Fair Grounds and Farmers Market, Inc., Debtor in Possession, #89669.

To all Claimants having filed claims in this proceeding:

Please take notice that on the day of January, 1956, an application by the Debtor in Possession will come on to be heard in Room at the United States Court House, Foley Square, New York City, at o'clock in the noon of that day, for the following relief:

1—Authorizing the expenditure of an additional $6,641.41 to cover the cost of the newly constructed building at the premises of the Debtor in Possession.

2—Granting leave to compromise for $8,000.00 the condemnation claim held by the Debtor in Possession against the State of Pennsylvania.

3—Granting leave to increase by $50.00 the weekly salary payable to Jerome Fried.

4—Granting leave to the Debtor in Possession to finance insurance policies over a Five year period.

All persons desiring to be heard on this application may appear at the hearing in person or by attorney. The papers on which the application is being made may be examined in the Office of the Clerk, United States Court House, Foley Square, New York City.

Alex L. Rosen, Attorney for Debtor in Possession,
225 Broadway, New York City.

[fol. 45] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

ORDER AUTHORIZING ADDITIONAL EXPENDITURES, ETC.—
January 13, 1956

At New York in said District on the 13th day of January, 1956.

Debtor in Possession having duly brought on for hearing before this Court on the 12th day of January, 1956 a motion for the following relief:

1. Authorizing additional expenditures to be made and already incurred by the Debtor in the sum of $6,641.41.

2. Granting leave to the Debtor in Possession to compromise and settle the claim against the State of Pennsylvania for condemnation of approximately one-third of an acre owned by the Debtor in Possession for the sum of $8000.00.

3. Granting leave to the Debtor in Possession to increase the salary paid to Jerome Fried for acting as Manager of the Debtor in Possession from the sum of $150.00 to the sum of $200.00 per week.

4. Granting leave to the Debtor in Possession to finance a five year payment of insurance premiums.

Now, upon reading and filing the Order to Show Cause herein made on the 28th day of December, 1955, the petition of the Debtor in Possession, verified the 27th day of December, 1955, the affidavit of Arnold A. Weinstein, sworn to the 27th day of December, 1955, the affidavit of Jerome Fried, sworn to the 24th day of December, 1955 and the affidavit of service of Anna E. Lubbe, sworn to the 30th day of December, 1955 and after hearing Benjamin Mar-

golis, Abraham Menin, of Menin & Herzog, Esqs., attorneys for claimants, Richard Hull and some of the stock-[fol. 46] holders present and after hearing Alex L. Rosen in favor of said motion, it is

Ordered that the Debtor in Possession be and it hereby is authorized to expend a total sum of $6,641.41, on account of the newly constructed building on the premises of the Debtor in Possession, and it is further

Ordered that Debtor in Possession be and it hereby is granted leave to compromise for $8,000.00 the condemnation claim held by the Debtor in Possession against the State of Pennsylvania, and it is further

Ordered that Debtor in Possession be and it hereby is granted leave to increase the salary paid to Jerome Fried, Manager of the Debtor in Possession, from the sum of $150.00 to the sum of $200.00 per week, and it is further

Ordered that Debtor in Possession be and it hereby is granted leave to finance a five year payment of insurance premiums.

Sidney Sugarman, U.S.D.J.

[fol. 47] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

REFEREE'S REPORT—November 6, 1959

To the Honorable, the Judges of the United States District Court for the Southern District of New York:

By order dated June 19, 1959 there was referred to me for hearing and report the petition of Irving J. Wolf, holder of stock of the debtor as agent for others, for an order directing that no compensation or reimbursement of expenses be allowed or paid to Arnold A. Weinstein, H.

Lawrence Laupheimer, Jerome Fried, and Nazareth Enterprises, Inc.; that they account for and restore all compensation and reimbursement received by them; and that the debtor recoup from each of them, all such compensation and reimbursement, pursuant to section 249 of the Bankruptcy Act. The petition was withdrawn as to Laupheimer. Fried and Nazareth Enterprises, Inc. were granted the benefit of any defenses and motions asserted by Weinstein whose motion to dismiss has been heard upon due notice and is the subject of this report.

The petition alleges that Weinstein, president of the debtor, received since September, 1953 a salary of $50. a week and expenses at the rate of $15. weekly; that his sister purchased six shares of the debtor's stock in 1957; that he purchased three shares in 1958 and sold a fraction of one share; and that he and, or, persons represented by him exercised in 1959 options to purchase six shares. It [fol. 48] further alleges that Fried, general manager of the debtor, has received since September, 1953 a salary at the rate of between $100. and $200. per week, that he purchased 20 shares of stock in 1957 and sold 10 of them; and that in an affidavit verified April 29, 1958 and filed herein, he alleged that certain expenses of the debtor for labor and materials had been paid by him and, or, Nazareth Enterprises, Inc., a corporation of which he is sole stockholder, and

> that he had advanced additional unspecified sums to Robert F. Sell "for the account of the Debtor", incident to the paving of the parking lot.

Section 249 of Chapter X of the Bankruptcy Act (11 U.S.C. 649) provides that

> persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him for his account, after the commencement of such proceeding.

It forbids the allowance of compensation or reimbursement

> to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

Weinstein & Fried, in the light of the allegations touching the positions and capacity they occupy are to be deemed, for the purpose of the motion, as acting in a fiduciary capacity to the corporation. Neither is alleged to have acted as an attorney or as a fiduciary or representative of any other person or of any class. The motion to [fol. 49] dismiss presents the question whether they are seeking compensation or reimbursement within the meaning of the section upon which the petition is grounded, and ineligible to receive any.

The section deals with "persons seeking" compensation or reimbursement. It may be theorized from the quoted words that the prohibition is operative though no formal application is made, and that the salaried respondents by working each week are seeking, in effect, compensation in the form of approved salaries. It is one of a number, commencing with section 241, comprised within Article XIII entitled "Compensation and Allowances", empowering the judge to allow reimbursement for cost and expenses and reasonable compensation to designated persons and groups in the reorganization and in prior proceedings. Section 247 provides that the judge fix a time of hearing "for the consideration of applications for allowances . . . " Bankruptcy Rule X-19 directs that every "application for compensation or allowance" shall include a detailed statement of the facts required to be stated under Section 249 of the Act but, like that section, does not impose the duty upon one not making an application for compensation.

If the section relied upon were applicable to the salaried respondents all its requirements, likewise, would be. Such

result would require them to file the statements under oath each week. The conclusion is that the section's prohibition against compensation or reimbursement is operative only against those who make formal application therefor.

[fol. 50] The citations of counsel include none in point. Surface Transit, Inc. v. Saxe, 266 F.2d 862, involved "applications for compensation filed below", page 865, and denied compensation to an attorney for a committee who sold bonds of the debtor he owned at the inception of the proceedings. In re International Match Corp., 190 F.2d 458, a proceeding in bankruptcy, concerned the recovery of commissions to a referee in excess of a court imposed limitation, and directed repayment. In re Stillwell, 12 F.2d 205 involved the denial or reduction of compensation. Restoration of an allowance to a trustee's attorney procured by fraud was required in Re De Ran, 260 Fed. 732, 739.

The power of a bankruptcy court to compel repayment of moneys is not limited to those obtained by fraud but extends to those unauthorized by law or judicial approval. The petition does not suggest that the salary payments were unauthorized. Nor does it state facts showing a breach of trust. At most it challenges applications for compensation or reimbursement which have not been made. Until they are section 249 is inapplicable.

It is recommended that the petition be dismissed.

New York, November 6, 1959.

Respectfully submitted,

John E. Joyce, Referee.

To Be Placed on the Bankruptcy Motion Calendar for Hearing

November 12, 1959,

and notice thereof given by mail to:

Melvin L. Robbins, Esq., 9 East 40th Street, (sic) York, N.Y.

[fol. 51] Arnold A. Weinstein, Esq., 225 Broadway, New York, N.Y.

Mr. Jerome Fried, P.O. Box 293,
Nazareth, Pa.

Alex L. Rosen, Esq., 225 Broadway,
New York, N.Y.

Charles Seligson, Esq., 350 Fifth Avenue,
New York, N.Y.

[fol. 52] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

MEMORANDUM—January 4, 1960

Sugarman, D. J.

The report of the learned Referee is disapproved.

I am of the opinion that Section 249 of the Bankruptcy Act announces a statutory prohibition against the payment of compensation pursuant to court order to salaried employees of the debtor who are fiduciaries and have traded in the debtor's stock. It is immaterial that the payments are made without formal application therefor.

The record thus far establishes that Weinstein and Fried are such salaried employees who are fiduciaries and have traded in the debtor's stock.

In so far as the petition seeks a termination of their further compensation it is granted.

[fol. 53] This leaves open only the question of recoupment. The court will take proof of the services rendered the debtor by Weinstein and Fried and of any other matters addressed to the value of their services and the equity of decreeing recoupment. This proof may be by reference to the record heretofore made in this Chapter X proceeding and any additional proof any party may wish to offer.

By January 14, 1960, the petitioner and the respondents Weinstein and Fried may each serve upon the others, the examiner, the debtor's attorney and Benjamin Margolis,

and file a schedule of such prior proof on the value of the services and equity of decreeing recoupment.

This hearing is adjourned to January 18, 1960 at 10:30 A.M., in Room 905, when any party may object to proof offered from the prior record and adduce additional proof on the said issues.

Settle an order.

Sidney Sugarman, United States District Judge.

Dated: New York, New York, January 4, 1960.

[fol. 54] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

REPORT OF EXAMINER APPOINTED UNDER SECTION 168—
Filed April 22, 1960

To the Honorable Sidney Sugarman, Judge of the District Court of the United States for the Southern District of New York:

Charles Seligson, Examiner herein, pursuant to Sections 167 and 168 of the Act of Congress relating to bankruptcy, and the orders of this court, reports as follows:

Preliminary Statement

1. On September 28, 1953, Nazareth Fairgrounds & Farmers Market, Inc., the above named debtor, filed with this court a voluntary petition for reorganization under Chapter X of the said Act. Thereafter, and on the same day, such petition was duly approved and an order was entered herein continuing the debtor in possession and authorizing it to operate its business, subject to the further order of the court. At all times since the debtor has continued in possession of its property and has conducted the operation of its business.

[fol. 55] 2. The debtor was incorporated under the laws of the State of Pennsylvania on the 7th day of August

1951. The principal business of the debtor has been the operation of a "Farmers Market", at Nazareth, in Northhampton County, Pennsylvania. The principal asset of the debtor is real property consisting of land and buildings. Space is rented in these buildings by the debtor to concessionaires and merchants who sell food, clothing, housewares and miscellaneous items.

3. On or about the 5th day of January 1955, an order was made and entered herein directing the filing of proofs of stock interests, as well as proofs of claims by creditors. As a result of such order, 41 proofs of stock interest were filed. In and by the 41 proofs of stock interest claims of ownership were asserted to an aggregate of 316 shares of the capital stock of the debtor, although the debtor's Certificate of Incorporation authorizes the issue of only 200 shares. On objections filed by the debtor to the allowance of five proofs of stock interest for 54 shares, hearings were held before the Honorable John E. Joyce, Referee in Bankruptcy, and the objections were sustained. On or about the 30th day of August 1957, an order was made by Referee Joyce disallowing these five proofs of stock interest made by Benjamin Margolis, Ida Mae Margolis, Sarah Kason, Bernard Ungar, and William McK Schongut (hereinafter referred to as the "Margolis group"). A review of the said order of disallowance is pending before this court.

[fol. 56] 4. On or about the 6th day of November 1957, the debtor filed objections to the allowance of the other 36 proofs of stock interest. In addition, objections to the allowance of a number of proofs of stock interest were filed by Benjamin Margolis. The debtor also filed objections to the allowance of several proofs of claim filed by alleged creditors. Pursuant to an order of this court, the objections to the allowance of proofs of stock interest were brought on by due and appropriate notice given to the stock claimants or their attorneys by the Examiner. Hearings were thereafter held before this court on such objections and all parties in interest were given an opportunity to adduce relevant proof. These hearings extended over a period of approximately 86 days, commencing May 19, 1958 and terminating on May 7, 1959.

5. On the 3rd day of October, 1956, an order was entered by this court, pursuant to Section 168 of the Bankruptcy Act, appointing Charles Seligson as Examiner to perform the duties imposed upon a trustee under Paragraphs (1) through (5) of Section 167 of the Act.

6. During the course of the Examiner's investigation of the acts, conduct, property, liabilities and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and other matters relevant to the proceeding, and in the performance of other duties under the said order of October 3, 1956 and other orders of the court, the Examiner has, at the direction of [fol. 57] the court, participated in numerous hearings. These hearings included hearings on the objections to the allowance of the proofs of stock interest at which the Examiner examined and cross-examined witnesses along with the attorneys for the debtor and for various stock claimants.

The Fundamental Issue Before This Court

7. It is impossible to formulate a fair, equitable and feasible plan of reorganization for the debtor without complete information and a resolution of the extent of the property, liabilities and financial condition of the debtor. Of paramount consideration in the formulation of any plan is determination of ownership of the capital stock of the debtor. It is extremely important for this court to decide which stock interests, if any, should be recognized as valid and subsisting and which stock interests should be rejected, in whole or in part. These determinations could result in the creation of additional claims against the debtor and could conceivably indicate causes of action available to the estate.

8. The debtor was incorporated on or about the first day of August, 1951. Commencing on or about the 17th day of October, 1951, and throughout the period of all of the transactions involved in the issuance of stock to the stock claimants herein, the debtor was dominated and controlled by one John Malakoff. Every claimant acquired his or her shares of Nazareth stock by means of transactions with or

through Malakoff or his agents. Malakoff commingled funds received by him from others for investment in Nazareth stock with his own funds and those of other cor- [fol. 58] porations controlled by him. None of the shares of stock issued to the claimants herein was sold and issued in a regular manner, that is, upon receipt of consideration passing directly to the debtor. The claimants, 36 in number, whose stock claims are the subject of this Examiner's report hold certificates aggregating 262 shares, representing an over-issue of 62 shares of stock. Furthermore, in substantially all cases the certificates were not issued to the stock claimants at or about the times when the stock claimants allegedly gave consideration to Malakoff for the issuance and delivery of such shares.

9. Each of the claimants, cognizant of the foregoing state of facts, seems to recognize the invalidity of his or her stock claim under strict rules of corporate law and practice. Each claimant bases his or her claim to a stock interest in the debtor upon equitable principles. Each relies upon the "broad equity power" vested in this reorganization court, "to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done." *Pepper* v. *Litton*, 308 U.S. 295, 304.

The Conflicting Claims

The Position of the Debtor.

10. The debtor has objected to the allowance of all 36 claims of stock interest. The debtor's objections are based generally on the following propositions: (1) that no consideration passed from any stock claimant directly to the [fol. 59] debtor and (2) that Malakoff was not entitled to the stock that was issued to each stock claimant. If the debtor's objections are upheld and all 36 stock claims are held invalid, the debtor will be without stockholders. The memorandum of law submitted by Alex Rosen, Esq., attorney for the debtor, does not ask that this extreme result be reached. The debtor's position as set forth in the memorandum submitted in its behalf is as follows:

(1) Malakoff did not purchase any interest in Nazareth for his own account but for the account of those who invested in Nazareth through him.

(2) An interest in Nazareth may be predicated only on the basis of a present consideration given to Malakoff for the express purpose of purchasing a Nazareth interest.

(3) The persons whose moneys were paid specifically for an investment in Nazareth are the beneficial owners of Nazareth and as to them Malakoff was a fiduciary.

(4) Malakoff, as a fiduciary, had no right to deplete the interests of bona fide investors by:

(a) The transfer of interests in Nazareth to satisfy or secure his personal obligations.

(b) The transfer of Nazareth stock for interests in real estate or for stock in other corporations which were transferred to him personally.

(c) The issuance of the debtor's paper or the diversion of its funds in payment of his personal obligations.

[fol. 60] (5) The distribution of the capital stock of Nazareth should be determined solely on equitable principles, so that any person (a) who participated in the machinations of Malakoff, or (b) who as an officer or director permitted Malakoff to divert the stock and assets of Nazareth, or (c) who was guilty of fraud, or (d) whose consideration consisted of usurious balances, or (e) who had knowledge of fraud or irregularities in the Nazareth promotion or management, or (f) whose hands are unclean on the basis of equitable considerations should not be permitted to share in the capital stock of Nazareth.

(6) On equitable principles, the time of payment to Malakoff for an interest in Nazareth, the time when Malakoff acquired any interest in Nazareth, the time of the issuance and receipt of stock certificates, and the fact of an overissue are not the crucial issues here involved.

(7) Each stock claimant is entitled to share in the Nazareth capital stock in proportion to the actual present consideration paid for the specific purpose of investing in Nazareth, less any return of capital. This is on the theory that the debtor's stock, as representative of the rest of the venture, is chargeable with a constructive trust for the benefit of those persons whose money was given specifically for investment in Nazareth.

11. Thus the debtor divides the claimants into two classes, subject to the provisos specified in Paragraph 9(5): [fol. 61] (a) those persons who paid a present consideration to Malakoff for the specific purpose of investing in the business and property of the debtor; and (b) those who received the debtor's stock in satisfaction of, or as security for, Malakoff's personal obligations.

12. The debtor's position is that the shares claimed by persons of the first class should be deemed valid and that those held by persons of the second class should be deemed invalid.

The Position of Davidson.

13. Robert R. Davidson and Irving J. Wolf (referred to in this report as "Davidson"), the assignees of the 102 shares described in the proofs of stock interest filed by Richard S. Hull (6 shares), Dorothy Kane (3 shares), Charles Kanter (40 shares), Frederick Katzenell (35 shares), Ernest Pollak (9 shares), Ann Rosen (6 shares), and Leslie Saul (3 shares) urge a different basis for this Court's determination of which shares are valid. As stated in their memorandum of law, interposed by their attorney, Melvin L. Robbins, Esq., the said assignees deem the time of payment for the shares to be dispositive in the determination of their validity. Davidson asks that the claimants be divided into four classes:

(1) investors prior to August 7, 1951, the date of incorporation of the debtor;

(2) investors after August 7, 1951 and prior to October 17, 1951, when John Malakoff acquired legal title to the first 20 shares of the debtor's stock (then the entire outstanding issue);

[fol. 62] (3) investors after October 17, 1951 and prior to February 2, 1953, the earliest date of issuance and delivery of any of the certificates of stock now held by claimants; and

(4) investors after February 2, 1953.

Davidson urges that the claims of those in the first three categories be allowed and that there be allowed only those of the fourth class who made contemporaneous advances to John Malakoff, and concurrently received stock certificates, regular on their face.

If the position of either the debtor or Davidson is adopted by this court, the total number of shares will be less than 200, and there will be no problem of overissuance. Both the debtor and Davidson do, however, urge that all overissued shares, that is, all shares issued after the first 200, are absolutely void.

The Position of other Stock Claimants.

14. At the hearings before this court, several other claimants appeared and testified in support of their own individual claims, without taking a position with respect to other claims or any overall position or theory concerning all of the stock of the debtor.

Arnold Weinstein appeared *pro se* and took the position that he should be deemed the owner of that proportion of the debtor's stock which $7,000, the amount of his investment, bears to the total amount paid by all *bona fide* investors, regardless of any "overissuance".

[fol. 63] Claimant Robert A. Noire, claiming five shares, appeared by his attorney, Nicholas Kohn, Esq., and testified in his own behalf. His position is the same as that of Arnold A. Weinstein.

Seymour Forman appeared by Louis R. Patur, Esq., and testified in his own behalf. He claims a participation as a stockholder to the extent of $10,000 on the same basis as the claims of Noire and Weinstein; he also claims to be a creditor in the amount of $5,000, or, if such claim is disallowed, participation as a stockholder to the extent of $15,000 worth of stock.

Herbert and Melvin Danciger and Gertrude Klein were represented by Leonard Franklin, Esq. The Dancigers claim to have become the owners of 11 shares of stock of the debtor, by applying said shares, held by them as collateral, toward satisfaction of antecedent indebtedness of John Malakoff to them. Gertrude Klein holds 14 shares and claims to have paid $14,000. Of the $14,000, she alleges that she paid $6,000 by application of that sum from her share of the proceeds of the sale of certain property in Philadelphia, held for her by John Malakoff.

The Facts Developed at the Hearings

The Organization of the Debtor and Acquisition of its Property.

15. The debtor is a corporation organized under the laws of the Commonwealth of Pennsylvania. It was formally incorporated on August 7, 1951. Its principal tangible assets consist of realty (land and buildings) located on a parcel of approximately 32 acres, situated at [fol. 64] the junction of Routes 12 and 45, Lower Nazareth Township, Northhampton County, Pennsylvania. The debtor, as landlord, actively operates its business on the premises.

16. On October 11, 1945 James A. Harter purchased the business and realty which later became that of the debtor. On the same day Harter mortgaged the realty to Rachel A. Metzger and Mildred E. Erickson, to secure payment of the principal sum of $8500. On January 11, 1949, Harter conveyed the realty and business to Nazareth Fairgrounds, Inc., a Pennsylvania corporation, all of the stock of which was owned by Harter and Laurena C. Shope. On the same day, Nazareth Fairgrounds, Inc. mortgaged the realty to Alice Kline, to secure payment of the principal sum of $14,500.

17. On March 13, 1951, a contract was executed by and between Nazareth Fairgrounds, Inc., seller, and Richard Realty Co., purchaser, for the sale of the business and realty, subject to certain existing and prospective mortgages, for the aggregate price of $66,000. On April 17,

1951, the transaction was consummated by the sale and conveyance of the business and realty to Richard Realty Co., in which John Malakoff had a one-fourth interest. The realty was conveyed subject to a first mortgage held by Metzger and Erickson in the amount of $8,500, the Kline mortgage, and a purchase money third mortgage to Harter and Shope in the amount of $10,000.

[fol. 65] 18. On April 20, 1951, the Kline mortgage was satisfied. Still outstanding were the Metzger and Erickson mortgage and the Harter and Shope purchase money mortgage.

19. On May 14, 1951, Richard Realty Co. sold the business and realty to Kipling Realty Co. for $100. The realty was sold subject to the two mortgages, the Metzger and Erickson and the Harter and Shope mortgages. Both Richard Realty Co. and Kipling Realty Co. were Pennsylvania corporations, all of the stock of which was registered in the name of Murray Realty Co., a Pennsylvania partnership of whom Edward Malakoff and Maurice Malakoff were the general partners. These corporations were used solely as dummy corporations for the purpose of transferring and taking title to property in various real estate transactions. Edward Malakoff's associates included his father, Maurice Malakoff, his brother-in-law, Milton R. Zoloth, two employees of Murray Realty Co., Paul Laury and Anna Spivak, and Morris Soble and Max Levy.

20. In July 1951, John Malakoff orally agreed to purchase the Nazareth real estate for the same price paid by the Richard and Kipling Realty Companies, to wit, approximately $66,000, plus an unresolved amount. The Philadelphia group had opened its books on the Nazareth joint venture, as of April 17, 1951, and these books reflected an original capital investment of $40,000 coming from Soble and $12,489 coming from John Malakoff. Within a week or ten days after the oral agreement, possession of the market was delivered to John Malakoff and he put his own manager in charge.

[fol. 66] 21. Despite the oral agreement to purchase the Nazareth real estate made by John Malakoff with Edward

Malakoff, or perhaps pursuant thereto, arrangements were made for the organization of a corporation to take over the Nazareth property and business. In anticipation thereof, the capital investment of $40,000 of Soble was adjusted so as to show a loan due Soble in the sum of $38,500 and a capital investment by him of $1,500.

22. On August 1, 1951 the articles of incorporation of Nazareth Fair Grounds & Farmers' Market, Inc. were executed by Zoloth, Laury and Spivak, who were incorporators, subscribers and initial directors. They subscribed to one share each. The office of the corporation was designated as Room 603, 1616 Walnut Street, Philadelphia, Pennsylvania, which was the office of Murray Realty Co.

23. The articles of incorporation of the debtor corporation provide, among other things:

> The authorized capital stock of the corporation is divided into two hundred shares of common stock without par value. The stated capital applicable thereto is $120,000.
>
> The value of the property with which the corporation will begin business is $1,500.

24. According to the debtor's minute book, the first meeting of shareholders was held at its office in Philadelphia on August 8, 1951. Present were Zoloth, Laury [fol. 67] and Spivak and the incorporators and subscribers. On August 9, 1951 the first meeting of directors was held at the company's office. Present were the directors named in the articles of incorporation, Zoloth, Laury and Spivak. The principal business transacted at the August 9th directors' meeting is summarized in a resolution reading, in part:

> That this Board accept the offer of Milton R. Zoloth and Morris Soble and purchase from them the business and property consisting of thirty-two acres of ground situated on the southwest corner of the intersection of Pennsylvania Routes Nos. 12 and 45 in Lower Nazareth Township, Pennsylvania, together with all of the assets of the said business, as set forth in a

copy of a balance sheet submitted by the said Milton R. Zoloth and Morris Soble, dated August 8, 1951, as follows:

(The balance sheet is summarized below)

Further Resolved, that this corporation assumes the payment of all of the obligations of the partnership as set forth above and that the President and Secretary of this corporation are authorized and directed to issue and deliver in accordance with the terms of the said offer, certificates for twenty full paid and non-assessable shares of this corporation to the said Milton R. Zoloth and Morris Soble.

25. The balance sheet referred to in the resolution shows assets consisting of realty valued at $66,456.50, improvements thereto of $9,794.64, less depreciation reserve of $1,023.75. Liabilities included a first mortgage (Metzger and Erickson) of $8,500 and a second mortgage of $9,500 (Harter and Shope), loans payable (without designation) of $57,135.92 and net worth of $1,500. The balance sheet also reflects a recapitalization reducing Soble's capital investment to $1,500, with the balance shown as a loan payable. The offer referred to in the resolution was made by Zoloth and Soble with Zoloth acting on behalf of the Murray [fol. 68] Realty Co. which owned all of the stock of the Kipling Realty Co. and with Soble representing his own interest.

26. On September 26, 1951 Kipling Realty Co. formally sold the business and realty to the debtor. The real property was sold subject to the mortgages aggregating $18,000 and the sales price was $100.

John Malakoff's Acquisition of the Stock of the Debtor.

27. On or about the 8th day of August 1951, Stock Certificate No. 1 for 10 shares of the Nazareth stock was issued to Milton R. Zoloth and Stock Certificate No. 2 for 10 shares of Nazareth stock was issued to Morris Soble. These cer-

tificates were signed for Nazareth by Milton R. Zoloth, President, and Paul Laury, Secretary, and the corporate seal was affixed to each certificate. Stubs for certificates numbered 1 and 2 have affixed thereto United States documentary stamps.

28. On October 17, 1951 a contract was executed between Zoloth and Soble, as sellers, and John Malakoff, as purchaser, whereby the entire outstanding issue of Nazareth stock (then 20 shares) was sold for the aggregate price of $32,853.08, ostensibly payable by deposit of $2,853.08 upon execution of contract, the balance of $30,000 due in ten equal monthly installments of $3,000 each, the first installment due November 17, 1951, and monthly thereafter until payment of the final installment on October 17, 1952.

29. The contract provided that title to the stock would pass to the purchaser immediately upon payment of the deposit of $2,853.08, receipt of which was acknowledged. The contract further provided that:

[fol. 69] 1. All the stock was to be held in escrow by Edward Malakoff (effectually as pledge-holder for the sellers) until full payment of the balance of $30,000;

2. John Malakoff was entitled to dividends on the stock;

3. Zoloth and Soble expressly retained voting rights on the stock until full payment by John Malakoff; and

4. In the event of John Malakoff's default in meeting any installment payments, all moneys received by Zoloth and Soble on account, were to be retained as liquidated damages by them, and title to the stock was thereupon to revert to Zoloth and Soble.

30. On October 17, 1951, Zoloth endorsed his Certificate No. 1 for 10 shares of the Nazareth stock over to John Malakoff and on October 22, 1951, Soble did likewise with respect to his Certificate No. 2. United States documentary stamps and Pennsylvania stock transfer tax stamps were affixed to each certificate in connection with the transfer thereof

to Malakoff. The certificates, however, were not actually delivered to John Malakoff until December 1952. At that time the corporate minute book and the books of account were also delivered to him.

31. In October 1951, after the Zoloth and Soble stock had been endorsed over to Malakoff, the records indicated that the sum of $57,135.92 was owed by Nazareth to Malakoff and in turn by him to the Philadelphia group. It also appeared that John Malakoff had obligated himself to pay the Philadelphia group the sum of $32,853.08 for 20 shares of Nazareth stock of the book value of $1,500.

[fol. 70] 32. There is a conflict in the evidence as to whether Malakoff assumed corporate control over Nazareth in October 1951 or thereafter and in 1952. Minutes back-dated to October 17, 1951 reflect a meeting of the Nazareth directors at which the old directors and officers resigned and Malakoff, Jerome Fried and Richard S. Hull were elected the new directors and Malakoff and Fried were elected officers. On the other hand, the evidence discloses that on several occasions in 1952, the officers of Nazareth were certified as Zoloth and Laury. Despite this conflict, it is clear that Malakoff had taken over control of the operation of the market before October 1951.

33. It will be recalled that in April 1951, Malakoff became a member of the joint venture which acquired the Nazareth business and realty. He acquired a one-fourth interest, represented by an advance or credit in the sum of $12,489, on or before April 17, 1951. Malakoff obtained the moneys for this advance or credit from others, including the $4,000 from Charles Kanter, $2,000 from G. Silver and $2,000 from M. Samet.

34. As of May 8, 1951, Malakoff had advanced the sum of $17,489 to the Philadelphia group. On that date these advances were converted on the books of the Philadelphia group from a one-fourth share by Malakoff in the joint venture to a credit to Malakoff against the debt to be created by him in favor of the Philadelphia group for acquisition of the Nazareth assets at a price to be agreed upon thereafter. Subsequently Malakoff made additional advances to

the Philadelphia group. Between April 1, 1951 and Febru-
[fol. 71] ary, 15, 1952, the Philadelphia group received a total of $49,489 from Malakoff in connection with the transfer and conveyance of the market from the Philadelphia group to Nazareth and Malakoff.

35. The Philadelphia group also received the sum of $11,032.84 representing the net proceeds of a windstorm loss to Nazareth in September and October 1952. This payment to the Philadelphia group was charged on the Nazareth books to Malakoff's loan account.

36. The total received by the Philadelphia group from Nazareth and Malakoff is $60,521.84. The amount that group was entitled to receive from Nazareth and Malakoff was $89,989. There is a balance of $29,467.16 due to the Philadelphia group under contracts with Nazareth and Malakoff. That group has not filed any proof of claim in this proceeding, and Edward Malakoff stated in court that the group did not intend to assert the indebtedness against the debtor.

37. On June 17, 1953, Malakoff's loan account with Nazareth reflected a credit to him of $68,442.92. This represented, among other items, the sum of $57,135.92 carried over from the joint venture upon incorporation plus two items, one of $9,507 and the other of $350. On June 17, 1953, Malakoff executed a formal release of any and all claims against Nazareth. On the same date, Malakoff assigned to Nazareth by endorsement thereof Stock Certificates No. 1 and 2, aggregating 20 shares, which had previously been endorsed over to him by Zoloth and Soble.

38. On June 17, 1953, Malakoff was insolvent and all of his creditors knew or had reasonable cause to believe that he was insolvent.

[fol. 72] *John Malakoff's Sales of Participations in the Nazareth Market and Stock of the Debtor.*

39. Claim No. 27 for 40 shares of Nazareth stock was filed by *Charles Kanter*. This claim is based upon Certificate No. 4 for 12 shares dated February 2, 1953, Cer-

tificate No. 71 for 8 shares bearing the same date and Certificate No. 72 for 20 shares dated April 17, 1953. According to the proof of claim, Certificate No. 4 was purchased on April 4, 1951, Certificate No. 71 on October 15, 1951 and Certificate No. 72 on April 17, 1953. The proof does not include a power of attorney but the back to which the proof is attached discloses that Maurice Harbater, Esq. is the attorney for claimant.

Objections to the allowance of Kanter's stock claim No. 27 were filed by the debtof and by Ida Mae Margolis, et al. The debtor's objections were grounded upon the contentions that Malakoff did not own the stock certificates which were delivered to claimant by Malakoff and that no consideration passed to Nazareth in exchange for the certificates issued to Kanter. The Margolis objections alleged that Stock Certificate No. 72 for 20 shares represented shares sold in excess of the authorized issue of stock of the debtor and were therefore void under Pennsylvania law; that there was no consideration for the issuance of the said stock certificate and that Kanter did not become a purchaser for value; that Kanter should have paid $20,000 for the 20 shares and at best paid only $12,000; and that [fol. 73] as a result of a conspiracy no objection was filed by the debtor to the allowance of the said 20 shares of stock. The Margolis group also objected to the allowance of Kanter's claim for 20 shares of stock represented by Certificates No. 4 and 71 on the ground that Malakoff had no shares to sell or transfer. Notice of a hearing on the said objections was given by the examiner to the claimant, Maurice Harbater, Esq. and other parties in interest.

Kanter first met Malakoff early in 1951. He was present in Malakoff's office when Ed Malakoff proposed to John Malakoff that he take a one-quarter interest in the market for $16,000. Kanter decided that he would invest $4,000 for a one-fourth interest in the one-fourth interest to be acquired by John Malakoff and he did this on or about April 10, 1951. He gave John Malakoff a check for $2,667 and $1,333 in cash or customers' checks. As evidence of his investment, Kanter received from John Malakoff, shortly after he made his advance, a promissory note of John Malakoff, Agent, for $4,000 payable to the order of Charles

Kanter on demand and dated April 11, 1951. Endorsed on this note is the legend "For 1/16 of interest in Nazareth Market".

Kanter's testimony is confusing as to when he was approached by Malakoff with respect to the purchase of additional shares. He first testified that about four months after his original purchase, Malakoff told him that he had acquired the other three-quarters of the market and that he was selling shares at $1,000 per share but to those who had [fol. 74] previously invested the shares would be $600 each. Later Kanter testified that about one month after the original purchase Malakoff told him that he was buying the rest of the market and intended to issue 200 shares selling at $1,0000 per share. According to Kanter, Malakoff told him that he was entitled to 12 1/2 shares since he had a one-sixteenth share of the market. Kanter claims to have purchased 8 additional shares for $600 each or a total of $4800 but the record is far from clear as to when and in what form the consideration passed to Malakoff, if at all.

Kanter had numerous transactions with Malakoff and it is impossible, except in a few instances, to identify checks from Kanter to Malakoff with particular transactions. It is significant that in answering a questionnaire on February 26, 1954, Kanter stated that he paid $4,000 for 10 shares in April 1951, $6,000 for 10 shares in November 1951, and on April 17, 1953 paid $12,000 for 20 shares.

Kanter did not produce a receipt for either the original $4,000 he claims to have paid to Malakoff in April 1951 or the $4800 he contends he gave Malakoff thereafter for 8 additional shares. He did submit the promissory note of John Malakoff, Agent, for $4,000 dated April 11, 1951 and a letter from John Malakoff to him dated January 15, 1952. This letter acknowledges receipt of a check (the amount not being stated), and recites that during the course of Malakoff's management of the market, he may cause the issuance to Kanter of 20 shares of his "present stockholdings". [fol. 75] Kanter did produce 2 checks, one for $2,500 dated May 10, 1951 payable to John Malakoff and the other for $500 dated June 6, 1951 payable to John Malakoff and he testified that these checks were originally given to Malakoff for investment in the Wales Hotel. He further testified

that at Malakoff's suggestion this $3,000 and cash or other moneys borrowed by Malakoff from Kanter from time to time were used to purchase 8 shares in Nazareth at $600 per share. Later in his testimony Kanter stated that he no longer remembered what the $500 check dated June 6, 1951 represented.

Malakoff's ledger supports Kanter's testimony of the advance of the original $4,000. The fact that additional moneys were advanced by Kanter to Malakoff in relation to Nazareth is also confirmed by so-called dividend checks issued by Malakoff to Kanter. Kanter produced a check for $2,700 dated January 22, 1952 payable to Charles Kanter and endorsed "Chas. Kanter" and "John Malakoff Agt." Over the endorsement of Kanter appears the words "Nazareth Market" but it is doubtful that these words were written before the check was endorsed by Kanter. In any event, Kanter testified that this check represented a loan to Malakoff to help the finances of the market and had nothing to do with Kanter's acquiring any stock in the market.

On September 1 and October 1, 1951, Kanter received checks of John Malakoff Agent for $100 each drawn upon the Corn Exchange Bank Trust Company. The word "Nazareth" appears over the endorsement of Charles Kanter [fol. 76] on each of these checks and it seems certain that these checks represented so-called dividends. Dividends of $100 monthly represent a return of 20% upon an investment of $6,000. Based upon Malakoff's practices it is reasonable to assume that as of September 1, 1951, Malakoff had received a total of $6,000 from Kanter for investment in Nazareth.

Between November 1, 1951 and April 1, 1953 inclusive, Kanter received on or about the first day of each month checks of John Malakoff, Agent or John Malakoff, Special or John Malakoff for $200 each except during the months of February and March 1953. All of these checks except the check dated April 1, 1953 (drawn upon the Manufacturers Trust Company) were drawn upon the Corn Exchange Bank Trust Company. Only one of these checks, that dated October 1, 1952, is identified with Nazareth but the testimony could support the conclusion that they represented so-called dividend payments upon an investment of $12,000 by Kanter

with Malakoff. It might be contended that these so-called dividend payments were given to Kanter upon an investment in one of Malakoff's other ventures and not Nazareth, except for the fact that the Siegel, Berg Co. report of June 30, 1953 on Nazareth discloses that Kanter received a $200 dividend check in February 1953 and another $200 dividend check in March 1953.

The stub for Certificate No. 4 for 12 shares discloses that the word "option" was originally written thereon and then crossed out. The stub for Certificate No. 71 bears the legend "no dividends" written in longhand in two places, the word "additional", and the word "void" crossed out. The stub for Certificate No. 72 discloses that it was originally [fol. 77] issued for 20 shares, then for 12 and thereafter for 20. It also has the following comments: "See agreement Ambassador Hotel"; "dividends on 12 shares"; "12,000.00 see JM" and "can buy back within 3 years 12000". In addition, the stub for this certificate originally had written out in longhand the word "option", which is crossed out.

Kanter produced an agreement dated April 17, 1953 between him and Malakoff which was marked in evidence. Under this agreement Kanter transferred to Malakoff any and all interest he had in Ambassador Estates, Inc. and the Hotel Margaret in Brooklyn, New York, and he released Ambassador Estates, Inc. from any and all claims. Malakoff agreed to cause to be issued to Kanter 20 shares of Nazareth stock. The agreement further provided that the stock should be endorsed to the effect that it was subject to the terms of the agreement. Malakoff was given an option to purchase part or all of the 20 shares of Nazareth stock at the rate of $600 per share. Malakoff also agreed to pay Kanter $2,000 at the rate of $50 weekly, and to make other payments against the $2,000 in the event the leasehold of the Margaret Hotel was sold by Ambassador Estates, Inc.

It thus appears that Kanter shifted an investment of $12,000 in Ambassador Estates, Inc. to Nazareth, and received 20 shares of Nazareth stock for that investment. Nothing was paid by Kanter to Nazareth at the time the said agreement was made and Certificate No. 72 was issued

to Kanter, and it does not appear that Nazareth was indebted to Kanter in any amount at that time.

[fol. 78] Kanter's position is that as to his first 12 shares he was a pre-incorporation subscriber and is therefore entitled to retain these 12 shares without regard to the consideration paid to Malakoff therefor. In regard to Certificate No. 72 for 20 shares, Kanter concedes that he is not entitled to the allowance of these 20 shares if the stock of four other claimant stockholders in his Class 4 are disallowed; otherwise he claims he is entitled to the allowance of such 20 shares. Concededly, Kanter made no contemporaneous advance to Malakoff when Stock Certificate No. 72 was delivered to him.

The debtor's position is that Kanter has not established having paid any consideration for his acquisition of any interest in Nazareth; and that he was engaged in usurious transactions with Malakoff and for these and other reasons Kanter's stock should be disallowed. The debtor also takes the position that it is entitled to "affirmative judgment for all damages caused to the debtor (or indirectly to the stockholders of the debtor the Court finds are legally such) for the monies realized by JM for the sale of the Debtor's stock over the amount paid for the acquisition of Nazareth".

The debtor has failed to establish any participation by Kanter in the so-called machinations of Malakoff. There is no evidence to support a finding that Kanter permitted Malakoff to divert the assets of Nazareth or findings that Kanter is guilty of fraud or had knowledge of fraud or irregularities in the Nazareth management. The evidence [fol. 79] is far from establishing that the consideration paid by Kanter to Malakoff consisted of usurious balances or that Kanter's hands are unclean.

Assuming that Malakoff controlled the issuance of the Nazareth stock, it would seem to make no difference whether he caused stock to be issued for a present cash consideration or an antecedent indebtedness. It should be noted that under the Uniform Fraudulent Conveyance Act consideration is fair when, in good faith, in exchange and as a fair equivalent therefor, property is transferred or an antecedent debt is satisfied.

On the basis of the so-called dividend checks it would appear that Kanter invested $12,000 in Nazareth through Malakoff. On the other hand, according to Kanter's own testimony, he invested only $4,000 for the first 12 shares of Nazareth stock that were issued to him and $4800 for the additional 8 shares. His total investment was therefore $8,800, apart from his investment in Ambassador Estates, Inc. Kanter received in dividends on his Nazareth investment a total of $3800. His net investment in Nazareth is $5,000. Kanter, however, is entitled to a credit of $12,000 for his investment of that amount in Ambassador Estates, Inc. which was transferred to Nazareth under the agreement of April 17, 1953. His total investment in Nazareth is therefore $17,000.

Accordingly, the sum of $17,000 constitutes the net fair value of Kanter's investment in Nazareth.

[fol. 80] 40. Claim No. 14 for 2 shares of Nazareth stock was filed by *Morton Samet*. Subsequently, and on or about the 11th day of March 1955, Samet filed an amended proof of claim No. 23, for 2 shares of Nazareth stock. This stock was represented by Stock Certificate No. 5, dated February 2, 1953, in the name of Morton Samet. Power of attorney was given to Herman R. Agins, Esq., 285 Madison Avenue, New York 17, New York. The amended claim apparently covered the same stock embraced by the original claim and specifically states that the consideration for the 2 shares of stock was the sum of $2,000 evidenced by checks, dated March 14, 1951 and April 10, 1951, in the amounts of $1500 and $500 respectively, both payable to the order of John Malakoff.

The debtor objected to the allowance of Samet's stock claim No. 14. These objections were grounded upon the contentions that Malakoff did not own the stock certificate which was delivered to claimant and that no consideration passed to the debtor in exchange for the certificate of stock issued to Samet. Notice of a hearing on the debtor's objections was given to Samet by the Examiner. Samet appeared at the hearing on the objection to the allowance of his stock claim, and made no point of the fact that the objections were directed to the original claim No. 14 rather than to the

amended claim No. 23. Moreover, Samet did not object to the notice of hearing on the ground that no notice had been given to his attorney in fact. All of the parties treated the objections as though they had been made to the allowance of Samet's claim No. 23.

[fol. 81] Early in 1951, Malakoff recommended or suggested to Morton Samet that he invest in a proposition involving Nazareth from which, he promised, Samet would get a very good return. Samet contends that in March and April 1951, he gave Malakoff a total of $2,000 for investment in Nazareth. In support of this contention, he has produced a check for $1500, dated March 14, 1951, signed by him, payable to the order of Malakoff and drawn upon the Freeport Bank of Freeport, New York, and another check for $500 dated April 10, 1951 made by him to Malakoff and drawn upon the same bank. Both checks were endorsed "John Malakoff" and "John Malakoff, Agent" and were deposited in Malakoff's Agent account in the Corn Exchange Bank Trust Company of New York. Samet did not get a receipt from Malakoff at the time but asked for one a month or so thereafter. He did not get a receipt then but in June of 1952 he received a handwritten letter from Malakoff, dated June 12, 1952, reciting that he had invested "in the sum of two thousand Dollars ($2000) which is a part share (1/32) in a deal, which is known as "Nazareth Market". This letter stated that the purchase price was $85,000 and mortgages $18,000 and that "Now, all you have to do is to take profits."

Samet had a number of other transactions with Malakoff after the Nazareth deal. Although he was unable to produce any checks covering transactions before 1951, Samet thinks that he had a lot of dealings with Malakoff in that period. From the inception of his transactions with Mala-
[fol. 82] koff, Samet approximates that the total amount given to Malakoff was $11,000. The amount collected from Malakoff, according to him, was $7,000 with the difference of approximately $4,000 represented by his investment in Nazareth.

Samet received only one stock certificate from Malakoff. This is Certificate No. 5, dated February 2, 1953, for two shares in the name of Morton Samet. The stock book stub

for Certificate No. 5 has the words "out" and "Hotel Margaret" written in longhand thereon, and no satisfactory testimony was adduced to explain the reason for the appearance of either of these two words on the stub. The stock certificate received by Samet was lost, and he testified that he did not sell, transfer or assign any of his interest in the stock certificate or any stock of Nazareth.

Eighteen checks for $33.34 each of "John Malakoff", "John Malakoff, Agent," or "John Malakoff, Special," payable to the order of Morty Sameth or M. Samet were received in evidence. These checks are dated on the 1st or 2nd day of each and every month, commencing with September 1, 1951 and continuing through May 1, 1953, except that there are no checks for October 1952 and February and March 1953. The testimony discloses that these checks represented so-called dividend payments to Samet on his investment in Nazareth.

Samet also received a check of "John Malakoff, Special," for $83.84, dated October 1, 1952, and drawn upon the Corn Exchange Bank Trust Company. This check has the word "Nazareth" written over the endorsement of M. Samet and apparently represents the so-called dividend of $33.34 for October 1952 and a $50 payment made to Samet by Malakoff [fol. 83] with respect to a separate transaction. A financial report of Siegel, Berg & Company on Nazareth, as of June 30, 1953, discloses that Samet received a check for $33.34, dated February 1, 1953, and a check for the same amount, dated March 2, 1953, of Nazareth drawn upon the Second National Bank of Nazareth, Pennsylvania. These checks undoubtedly represented so-called dividends for the months of February and March 1953. Thus Samet received a total of $700.14 on his investment in Nazareth. Since no dividends were actually paid or earned, these payments should be regarded as a return of capital by Malakoff to Samet. Further, the fact that Malakoff paid these so-called dividends to Samet on the basis of an investment of only $2,000 negatives Samet's testimony that approximately $4,000 was invested by him in Nazareth. Malakoff's ledger confirms that he acquired a one-fourth interest in Nazareth in the Spring of 1951 and, in connection therewith, received $2,000 from Samet.

The longhand writings on stub No. 5 of the Stock Certificate Book would seem to indicate that the stock certificate was issued to Samet in connection with a transaction involving Hotel Margaret. These writings also suggest the possibility that Stock Certificate No. 5 may have been returned to Malakoff by Samet or was destroyed pursuant to an agreement under which any debt from Malakoff to Samet in respect of Nazareth was cancelled. On the other hand, since Samet received the so-called dividend payments through April 1, 1953, it is unlikely that such an agreement was made.

[fol. 84] On all the evidence, it is clear that the maximum invested by Samet in Nazareth was $2,000. It is equally clear that the maximum credit to which he is entitled for his investment in Nazareth through Malakoff is $1,299.86, which represents the difference between his maximum investment and the so-called dividends received by him. The said sum of $1,299.86 constitutes the net fair value of Samet's investment in Nazareth.

41. Claim No. 35 was filed by *Gertrude Klein.* This claim is for $14,000 and states that the consideration was payment of that amount to John Malakoff, President of Nazareth, for the purchase of 14 shares of Nazareth stock. The claim also states that the purchase was made in six transactions on April 2, 1951, September 20, 1951, October 16, 1951, January 21, 1952, October 23, 1952 and November 15, 1952, for which Stock Certificate No. 6 in the amount of 14 shares was issued to claimant on February 2, 1953.

Objections to the allowance of Claim No. 35 were filed by the debtor on the usual grounds, to wit, that Malakoff did not own the stock that was delivered to claimant and that no consideration passed from claimant to Nazareth. In addition, the debtor alleged that all or a portion of the purported payments for the purported purchase of stock was based on past due indebtedness or on past transactions that claimant had with Malakoff personally. Claimant is referred to as Gertrude Silver Klein. Notice of a hearing on said objections was given by the Examiner to the claimant and the debtor.

[fol. 85] Claimant Gertrude Klein testified that she had known Malakoff practically all her life. She had financial transactions with Malakoff prior to the time she discussed Nazareth with him. She first talked to Malakoff about the Nazareth market prior to April 1951. She gave Malakoff a check for $2,000 dated April 2, 1951 representing an investment of that amount in Nazareth. This check, which she produced, is payable to John Malakoff, is endorsed John Malakoff and John Malakoff, Agent, and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. When she gave this check to Malakoff, Mrs. Klein was told that she would be getting 20% interest on her investment and that Malakoff was going to issue stock to cover the investment. Mrs. Klein did not get a receipt from Malakoff for her $2,000 investment.

Thereafter, and on or about September 20, 1951, Mrs. Klein made a further investment of $1,200 in Nazareth. This investment was evidenced by a check payable to John Malakoff dated September 20, 1951 endorsed John Malakoff and John Malakoff, Agent. This check was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Over the endorsement appears the word "Nazareth". Mrs. Klein did not get a receipt from Malakoff covering this $1,200 investment.

Mrs. Klein claims that she made a further investment in Nazareth of $2,300 on or about January 21, 1952 by a check bearing that date payable to John Malakoff. This check is endorsed John Malakoff and John Malakoff, Agent. It is not clear from the endorsement in what account this check was deposited. When Mrs. Klein gave this check to Malakoff, she was told that she would get 20% interest [fol. 86] and that Malakoff intended to issue stock which would eventually be sent to her. Mrs. Klein testified that some time between January and February of 1952, she gave Malakoff $500 in cash in one lump sum and that she obtained this cash by cashing a bond.

According to Mrs. Klein, on April 10, 1952 she gave Malakoff a check for $2,000 as a loan and several months later Malakoff told her that he would credit the $2,000 to Nazareth, thus bringing her investment in Nazareth up to $8,000. To substantiate this testimony, Mrs. Klein produced

photostatic copy of a check dated April 10, 1952 for $2,000. This check was endorsed John Malakoff and John Malakoff, Agent. It also appears that Mrs. Klein made an investment of $5,500 with Malakoff in connection with certain property in Philadelphia known as the Locust Properties Inc. She claims that as a result of this investment she was entitled to get back a total of $6,000 and that she told Malakoff she wanted that money invested in Nazareth. She was given six shares of Nazareth stock by Malakoff in consideration of $6,000. Mrs. Klein produced papers which confirm her investment in Locust Properties Inc. and the fact that she should have received a return of at least $6,000 therefrom.

The only receipt that Mrs. Klein seems to have obtained from Malakoff is a letter dated November 15, 1952 addressed to Gertrude Silver Klein and signed John Malakoff. This letter acknowledges the receipt "of your monies of $14,000.00 in the matter of the Nazareth Farmers & Auction Market at Nazareth, Pennsylvania." In the typed [fol. 87] portion of the letter it is stated that all of the authorized stock of the Nazareth Farmers & Auction Market Inc. "which owns the Market" has been issued "to me (Malakoff)". The typed portion states that dividends of 20% per annum have been declared and that a dividend at that rate will be paid on the first day of each month. It also states that he (Malakoff) may cause the dissolution of the corporation and arrange for the formation of a limited partnership, in which Mrs. Klein would be a limited partner, and her "14/200 will be applied as contribution with a corresponding proportionate interest". At the bottom of this letter after Malakoff's signature appears the following in longhand: "At this date there are 200 shares issued in my name of which you are a partner. No shares have been distributed to any of my clients who invested in Nazareth."

On or about September 1, 1951, Mrs. Klein received a dividend check (make payable to Gertrude Silver) for $33.34 signed by John Malakoff, Agent and drawn upon the Corn Exchange Bank Trust Company. The words "Nazareth, Pa." appear over the endorsement of Gertrude Silver. This amount represents 1/12th of 20% of $2,000 and supports Mrs. Klein's testimony that as of September 1, 1951

she had invested with Malakoff in Nazareth the sum of $2,000. This testimony is also supported by an entry in Malakoff's ledger of a $2,000 advance from G. Silver in connection with his one-fourth interest in Nazareth. A check dated October 1, 1951 of John Malakoff, Agent in the sum of $41.34 was made payable to Gertrude Silver and bears her endorsement. Over her endorsement is the [fol. 88] word "Nazareth". This would seem to represent one month's interest on $2,000 and approximately one-third of a month's interest on an additional $1200. On November 1, 1951, December 1, 1951 and January 2, 1952 checks for $53.34 each of John Malakoff, Agent were issued to Gertrude Silver or G. Silver. These checks represent monthly interest on $3200 at the rate of 20% per annum.

On February 1, 1952, a check of John Malakoff, Special, in the sum of $66.14 was issued to Gertrude Klein. This check was endorsed Gertrude Klein and Gertrude Silver and was drawn upon the Corn Exchange Bank Trust Company, as were the three checks for $53.34. The difference of $2.80 between $66.14 and $53.34 apparently represented interest on an additional amount paid to Malakoff by Mrs. Klein in cash for investment in Nazareth.

Thereafter and on March 1, 1952, April 1, 1952, May 1, 1952, June 2, 1952, July 2, 1952, August 1, 1952 and September 1, 1952 checks for $100 each of John Malakoff, Special, drawn on the Corn Exchange Bank Trust Company were issued to G. Silver. These checks represent monthly interest at the rate of 20% per annum on $6,000. On October 1, 1952 a check of John Malakoff, Special in the sum of $133.34 was issued to G. Silver and drawn on the Corn Exchange Bank Trust Company. Over the endorsement of G. Silver is the word "Nazareth". The amount of this check is equal to 20% interest per annum on $8,000.

[fol. 89] On November 1, 1952, December 1, 1952 and January 2, 1953 checks of John Malakoff, Special, each for $233.34 drawn upon the Corn Exchange Bank Trust Company were issued to Gertrude Silver, G. Silver and Gertrude Silver Klein, respectively. On April 1, 1953 a check of John Malakoff for $233.34 drawn upon the Manufacturers Trust Company was drawn to the order of Gertrude Silver Klein. These checks represented interest of 20% per annum

on $14,000. Mrs. Klein also received dividend checks of $233.34 each in February and March 1953 from the bank account of Nazareth in the Second National Bank of Nazareth, Pennsylvania. In addition, she produced a check of John Malakoff dated May 1, 1953 payable to her order in the amount of $233.34 drawn upon the Manufacturers Trust Company which was returned unpaid because the account had been closed.

Stock Certificate No. 6 which was issued in the name of Gertrude Silver Klein is dated the 2nd day of February 1953 and is signed by Jerome Fried, Secretary, and John Malakoff, President. The certificate is for 14 shares but the numeral 14 and the word fourteen seem to have been written over a different numeral and a different word amount. The stub for Certificate No. 6 also indicates that the numeral 14 was written over a different numeral and this stub has the word "option" and the word "out". In a questionnaire which was sent to Mrs. Klein and sworn to by her on the 24th day of February 1954, Mrs. Klein stated as follows:

[fol. 90] "I gave Mr. Malakoff monies for investment in Nazareth as follows:

Apr. 2-1951	$2,000.
Sept. 20-1951	1,200.
Oct. 16-1951	2,000.
Jan. 21-1952	2,300.
Cash	500.

Money received from sale of Phila. property $6000. Mr. Malakoff asked me if I wanted to invest the money in Phila. property in Nazareth. I agreed. November 15, 1952 I received a form letter from Mr. Malakoff telling me that I was the owner of 14 shares of Nazareth stock. Feb. 2-53— received Stock Certificate for 14 shares."

The position of the debtor is that the amount of present consideration paid at the time of a particular purchase of Nazareth stock or interest by Mrs. Klein is for the court to determine. The debtor also charges that Mrs. Klein engaged in usurious transactions with Malakoff and that as

to some of her transactions with Malakoff in which she received Nazareth stock the consideration was an antecedent indebtedness. There is no clear evidence of any usurious transactions by Mrs. Klein with Malakoff, and whether or not there was a present, as distinguished from a past consideration at the time Mrs. Klein arranged to acquire Nazareth stock from Malakoff, is unimportant. Mrs. Klein undoubtedly advanced $14,000 to Malakoff at some time and he was indebted to her in that amount at the time the stock certificate was delivered to her, and prior thereto. In this case it seems clear that Malakoff paid the so-called dividends to Mrs. Klein upon an actual investment by her in Nazareth of $14,000.

[fol. 91] Mrs. Klein's total investment in Nazareth is $14,000. She received in dividends a total of $2,534.22. Her net investment in Nazareth is therefore $11,465.78. Accordingly, the sum of $11,465.78 constitutes the net fair value of Mrs. Klein's investment in Nazareth.

42. Claim No. 29 for 3 shares of Nazareth stock was filed by *Dorothy Holober Clark*. This claim is based upon Certificate No. 11 for 3 shares dated February 2, 1953. The consideration for the stock, as set forth in the proof of claim, was as follows: check of Dorothea Holober for $200 to John Malakoff dated March 11, 1952, check of Dorothea Holober for $500 to John Malakoff dated March 27, 1952, check of Dorothea Holober for $550 to Helen Bernstein dated July 30, 1952, check of Dorothea Holober for $1,125 to the order of Cash dated September 29, 1951 and $625 in cash paid to Helen Bernstein in or about October 1951. Power of attorney runs to Bernard Buchwald, Esq., 16 West 46th Street, New York, New York.

Objections to the allowance of Dorothy Holober Clark's Stock claim No. 29 were filed by the debtor and by Ida Mae Margolis, et al. The debtor objected on the ground that Malakoff had no title to the stock transferred to claimant and the further ground that no consideration passed to Nazareth. The Margolis objections attempt to incorporate certain objections filed by the debtor to the stock claims of Margolis, et al. Notice of a hearing on said objections was given by the Examiner to claimant and other parties in interest, including Bernard Buchwald, Esq.

[fol. 92] Dorothy Holober Clark is the wife of Barry Clark, another claimant. She met Malakoff and Helen Bernstein through Harold Masur, her husband's friend. Shortly after this meeting, Malakoff asked her whether she would like to buy shares in the Nazareth market. According to claimant, she told Malakoff that she did not have cash available but that if she could pay off the price in installments she would like to own three shares. Malakoff apparently agreed to this arrangement. After this arrangement was concluded, and in the early part of 1951, Mrs. Clark was employed by Malakoff and she worked in his office for two or three weeks.

Mrs. Clark testified that she gave Malakoff several checks to pay for her shares in Nazareth. In support of this testimony, she produced the following checks: check for $1,125 dated September 29, 1951 payable to Cash endorsed John Malakoff, Agent and deposited by him in the Corn Exchange Bank Trust Company, check for $200 to John Malakoff dated March 11, 1952 endorsed John Malakoff and John Malakoff, Agent, and deposited in the Corn Exchange Bank Trust Company, check for $500 to John Malakoff dated March 27, 1952 and endorsed John Malakoff and John Malakoff, Agent and deposited in the Corn Exchange Bank Trust Company and check for $550 to Helen Bernstein dated July 30, 1952 endorsed Helen Bernstein and Ambassador Estates, Inc., and deposited in an account in the Corn Exchange Bank Trust Company. These four checks were signed by Dorothea Holober and were all drawn on the National City Bank of New York, 86th Street Branch. In addition, claimant produced a check of the Manhattan Savings Bank for $500 dated June 1, 1951 payable to [fol. 93] Dorothy Holober. This check was endorsed over to Helen Bernstein and by her endorsed Helen Bernstein and Helen Rothschild. This check too was deposited in an account in the Corn Exchange Bank Trust Company.

Mrs. Clark also testified that she gave Malakoff $125 in cash three or four weeks after the last check was given to Malakoff but did not get a receipt therefor. This money she said she obtained as alimony from her former husband. When she paid for the three shares of stock, Mrs. Clark received a letter from Malakoff acknowledging receipt

of the money and stating that she was the owner of three shares of stock in Nazareth. The letter also stated that she would receive a stock certificate. This letter, Mrs. Clark testified, was returned to Malakoff at his request. She also testified that she made no other investment with Nazareth and had no other transactions with him. She said that the $3,000 given to Malakoff for investment in Nazareth was not returned to her. Mrs. Clark did admit that she exchanged checks with Malakoff on many occasions but she claims that she never received any moneys from him and made no profits in any transactions with him.

Claimant produced a letter which she testified accompanied the stock certificate which was sent to her by Malakoff in February 1953. This letter, which is dated February 2, 1953, states that formal certificate of stock evidencing Mrs. Clark's stock ownership in Nazareth is enclosed and requests the return of a letter agreement in which her interest in the corporation had been previously acknowledged. The stub for Stock Certificate No. 11 is regular on its face and contains no qualifications or conditions whatsoever.

[fol. 94] Claimant received 10 checks for $33.34 each dated the first or the 2d day of each month commencing with November 1951 and ending August 1952. These monthly payments represented 1/12th of 20% per annum interest on $2,000. These checks were signed by John Malakoff, Agent or John Malakoff, Special, were payable to D. Holober or Dorothy Holober and were drawn on the Corn Exchange Bank Trust Company. Claimant also received two checks for $50 each, one dated September 1, 1952 and the other October 1, 1952, signed by John Malakoff, Special, and drawn on the Corn Exchange Bank Trust Company. In addition, claimant received three checks for $45 each dated November 1, 1952, December 1, 1952 and January 2, 1953 signed by John Malakoff, Special and drawn upon the Corn Exchange Bank Trust Company. John Malakoff also gave her a check for $50 dated April 1, 1953 drawn on the Manufacturers Trust Company, which he redeemed in cash, and a check for $50 dated May 1, 1953 drawn on the Manufacturers Trust Company. Mrs. Clark got two $50 payments from the Nazareth account in the Second National

Bank of Nazareth, one in February and the other in March 1953. The $50 payments represented 1/12th of 20% per annum interest on $3,000 and the $45 payments represented 1/12th of 20% per annum interest on slightly less than $3,000.

It is clear that all of the monthly payments mentioned above represented so-called dividends on the investment made by Mrs. Clark on Nazareth stock. These dividends actually represented a return of capital. Mrs. Clark received a total of $768.40.

[fol. 95] The testimony of claimant is contradictory. Nevertheless, there is sufficient in the record to justify a finding that claimant actually advanced $3,000 to Malakoff for investment in Nazareth. The debtor calls attention to the fact that claimant's signature appears on the endorsement of a number of Malakoff checks but that has no real significance. Her testimony that she cashed these checks for Malakoff is believable under all the circumstances.

The sum of $2,231.60 constitutes the net fair value of the investment of Dorothy Holober Clark in Nazareth.

43. Claim No. 28 for 4 shares of Nazareth stock was filed by *Barry Clark*. This claim is based upon Certificate No. 12 dated February 2, 1953. The claim has a rider attached thereto stating that the $4,000 was paid as follows: check of East River Savings Bank to Helen Bernstein dated August 1, 1951 for $2,000; check of New York & Suburban Federal Savings & Loan Association to Helen Bernstein dated August 1, 1951 for $1,000 and check of East River Savings Bank to John Malakoff dated November 10, 1952 for $1,000. Power of attorney runs to Bernard Buchwald, Esq., 16 West 46th Street, New York, New York.

Objections to the allowance of Barry Clark's stock claim No. 28 were filed by the debtor and by Margolis, et al. The debtor's objections alleged that Malakoff did not own the stock certificate given to claimant and that no consideration passed to the debtor. The objections of Margolis charges lack of action against the Barry Clark claim by the debtor, and also that the claimant has offered no proof that the payments made to Helen Bernstein were

[fol. 96] ultimately received by Malakoff or the debtor. Notice of a hearing on the said objections was given by the Examiner to the claimant and other parties in interest, and claimant appeared in person at the hearing on the objections.

Clark first met Malakoff and Helen Bernstein through a friend, Harold Masur, early in 1951. About six months later, Malakoff asked Clark to buy stock in Nazareth, and he agreed to buy three shares at $1,000 per share. The actual purchase was made about one month thereafter. Claimant supported his testimony by producing photostatic copy of a check of the East River Savings Bank for $2,000 dated August 1, 1951 payable to Helen Bernstein and a check of the New York & Suburban Federal Savings & Loan Association for $1,000 was dated August 1, 1951 and payable to Helen Bernstein. The East River check was endorsed Helen Bernstein, John Malakoff, Agent, and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. The Loan Association check for $1,000 was endorsed Helen Bernstein and was deposited in the Corn Exchange Bank Trust Company, apparently in an account in the name of Helen Bernstein.

Claimant also produced a letter from John Malakoff dated August 1, 1951 addressed to Barry Clark stating that Malakoff was holding in escrow the sum of $4,000 which Clark had invested with him "in the deal in Nazareth, Penna., known as the Nazareth Farmers & Auction Market." This letter stated that Clark's investment represented four shares of stock in the transaction which Clark, in turn, would hold in escrow until the deal was consummated. [fol. 97] A return of 20% per annum payable monthly was promised. Clark testified that he did not get a receipt after giving Malakoff the two checks aggregating $3,000 despite the fact that he produced the receipt dated August 1, 1951. He also testified that he undertook to purchase the fourth share of Nazareth stock at some time prior to August 1 but on cross-examination said that he gave Malakoff his check for $1,000 for the fourth share on November 10, 1952. Later, on redirect examination, he said that he gave Malakoff $1,000 in cash on August 1, 1951, in addition to the moneys represented by the two checks for $1,000 and $2,000.

According to Clark, in 1952 he bought one share of stock in the Margaret Hotel for $1,000 and that was the only transaction that Clark had with Malakoff outside the Nazareth deal. Clark was positive he never loaned Malakoff $1,000 or any other money.

Stock Certificate No. 12 was received by Clark from Malakoff in a letter dated February 2, 1953. This letter stated that the certificate evidenced Clark's stock ownership and requested the return of the earlier letter agreement. The stub for Stock Certificate No. 12 indicates that the certificate was issued without any conditions or qualifications.

A check of John Malakoff, Agent, for $50 drawn on the Corn Exchange Bank Trust Company dated September 1, 1951 and payable to Barry bears the endorsement Barry and a stamp indicating that the check was deposited in the account of M. S. Sternberg, Special. Over the word "Barry" appears the following: "Nazareth, Pa." This [fol. 98] check undoubtedly represented a dividend to Barry Clark, although he denies endorsing it. He does, however, admit that he received a dividend of $50 in September 1951. On the first or second day of every month commencing with October 1951 and ending January 1952, checks of John Malakoff, Agent, or John Malakoff, Special, in the sum of $66.67 each were issued to Barry or Barry Clark or B. Clark and drawn upon the Corn Exchange Bank Trust Company. These checks were all duly endorsed and Clark acknowledges the receipt thereof. Clark also received a check of John Malakoff for $66.66 dated April 1, 1953 drawn upon the Manufacturers Trust Company and a Nazareth check for $66.67 drawn on the Second National Bank of Nazareth and dated February 2, 1953. The Siegel, Berg report does not reflect a payment of $66.67 to Clark in March 1953 from the account in the Second National Bank but Clark undoubtedly received the March 1953 dividend from Malakoff in one form or another. He also received a dividend check for May 1953 but that was returned from the bank unpaid.

Clark received a check for $1,000 drawn on the account of John Malakoff, Agent, in the Corn Exchange Bank dated

December 10, 1952. Clark's testimony is that he cashed this check for Malakoff. The debtor's position is that the court must determine whether Clark received this $1,000 in reduction of Clark's investment in Nazareth or whether he actually cashed the check for Malakoff as he testified he did.

Malakoff recognized Helen Bernstein as his agent. Malakoff should be charged with the receipt of the $1,000 Savings & Loan Association check payable to the order of Helen Bernstein. Malakoff's letter of August 1, 1951 ac- [fol. 99] knowledges receipt of $4,000 from Clark and the so-called dividend payments on $4,000 confirm the receipt by Malakoff of $4,000 for investment in Nazareth. The testimony of Clark that he cashed the $1,000 check for Malakoff is consistent with other testimony of Malakoff's practices, and Clark's testimony is worthy of belief.

Clark gave Malakoff $4,000 for investment in Nazareth. He received a total of $1,316.73 in so-called dividends. His net investment in Nazareth is therefore $2,683.27. Accordingly, the sum of $2,683.27 represents the net fair value of Barry Clark's investment in Nazareth.

44. Claim No. 22 for 4 shares of Nazareth stock was filed by *Harold Q. Masur*. This claim is based upon Certificate No. 13 dated February 2, 1953. The consideration for the stock, as set forth in the stock claim, is as follows: check of Union Square Savings Bank for $3,000 to Harold Q. Masur dated August 1, 1951 and endorsed over to Malakoff; claimant's check for $400 dated September 12, 1951 to Malakoff; check of Union Square Savings Bank for $500 to Harold Q. Masur dated November 10, 1952 and endorsed over to Malakoff; and claimant's check for $150 to Malakoff dated November 12, 1952. Power of attorney runs to Bernard Buchwald, Esq.

Objections to the allowance of Masur's stock claim No. 22 were filed by the debtor and Benjamin Margolis, et al. The debtor objected on the ground that Malakoff had no title and that no consideration passed to Nazareth. The Margolis objections attempt to incorporate objections filed by the debtor to the stock claims of Benjamin Margolis, et al. Notice of a hearing on the said objections was given by the

[fol. 100] Examiner to claimant, the attorney for the debtor and the attorney for the Margolis group of objectors. No notice was given to Bernard Buchwald, Esq. but the claimant appeared in person at the hearing on the objections.

Masur first discussed Nazareth with Malakoff around the middle of July 1951. Malakoff told him that he intended to take over a Farmers Market in Nazareth, that it looked like it might be a profitable proposition, and Malakoff invited Masur to drive with him to Nazareth. Masur was told that there were 200 shares of stock available.

On or about August 1, 1951, Malakoff persuaded Masur to take 3 shares of stock for which Masur gave him a check for $3,000. Masur has produced a photostatic copy of a check of the Union Square Savings Bank dated August 1, 1951 for $3,000 payable to his order. This check was endorsed to the order of John Malakoff by Harold Q. Masur and was then endorsed by John Malakoff and John Malakoff, Agent and deposited in the Corn Exchange Bank Trust Company. According to Masur, on September 12, 1951, Malakoff persuaded him to buy another share of stock. Masur's testimony was confusing as to how he paid for this additional share of stock. He testified that he gave Malakoff a check for $400 on that date and he has produced a check for that amount dated September 12, 1951 to the order of John Malakoff. This check was endorsed John Malakoff and John Malakoff, Agent, and was deposited in the Corn Exchange Bank Trust Company. Over the endorsement of John Malakoff appears the word "Nazareth" and the ink on this endorsement seems to correspond with [fol. 101] the ink used for the writings on the face of the check. Masur said that he did not give Malakoff the balance until November 1952 at which time he gave Malakoff a check of the Union Square Savings Bank for $500 and a couple of days later $100 in cash. This testimony cannot be accurate and Masur seems to have been confused. The first dividend check that Masur received from Malakoff is dated October 1, 1951 and is in the sum of $66.67. This amount represents 1/12th of 20% per annum interest on $4,000 so Masur must have given Malakoff the balance of $600 some time in September 1951. It is doubtful that Malakoff would have paid Masur a dividend on $600 which

he had not actually received from Masur. Masur testified that he entered into a deal with Malakoff involving a tavern in Larchmont and gave Malakoff $500 for that deal. He said that the deal fell through and Malakoff repaid Masur the $500 in cash around November 1951. Masur produced a check for $500 to Malakoff and over Malakoff's endorsement there is a reference to a Larchmont deal. This check is dated August 22, 1951. It is likely that the Larchmont deal fell through in September and that Masur used the $500 for his investment in Nazareth.

Beginning October 1, 1951 each month through May 1953, except for the months of February and March 1953, Masur received checks for $66.67 monthly from Malakoff representing dividends on his Nazareth investment. These checks were made by John Malakoff Agent, or John Malakoff, Special, and were drawn on the Corn Exchange Bank Trust Company or were made by John Malakoff and were drawn on the Manufacturers Trust Company. In addition, [fol. 102] Masur received $66.67 in February and March 1953 from the Nazareth account in the Second National Bank of Nazareth. Thus Masur received a total of $1,333.40.

When Masur first went to Nazareth, Pennsylvania, to see the market, he travelled with Malakoff. Masur did not ask Malakoff whether there was a corporation nor did he make any effort to get information as to operations. In his dealings with Malakoff, there was no talk about stock ownership in Nazareth but rather about a one-fiftieth interest in the market. Masur got from Malakoff a letter dated September 11, 1951 acknowledging that Malakoff was holding in escrow the sum of $4,000 which represented one-fiftieth ownership in the market. This letter stated that the return on Masur's investment would be 20% per annum, payable monthly. The stock certificate was actually received by Masur in a letter from Malakoff dated February 2, 1953. The stub for Certificate No. 13 is regular on its face and contains no qualifications or conditions whatsoever.

Masur was asked to answer a questionnaire by the attorney for the debtor. In this questionnaire, which was sworn to by Masur on January 28, 1954, Masur said that on September 12, 1951 he gave Malakoff a check for $400

and to the best of his recollection cash for the balance of one more share. At that time, so Masur said in the questionnaire, Malakoff took back a letter receipt which he had given to Masur on August 1, 1951, and gave Masur a second letter confirming Masur's investment of $4,000 for 4 shares, dated September 11, 1951. This answer of Masur to ques-
[fol. 103] tion 8 of the questionnaire is consistent with Malakoff having started to pay dividends on $4,000 on October 1, 1951.

The debtor calls attention to certain contradictions in Masur's testimony. These contradictions have been resolved satisfactorily. Masur was a truthful witness and simply could not recall precisely what had happened at times in his dealings with Malakoff. Concededly, Masur gave no money directly to Nazareth and there is no evidence of any indirect payments to Nazareth. Nonetheless, the sum of $2,666.60 constitutes the fair value of Masur's investment in Nazareth.

45. Claim No. 19 for 6 shares of Nazareth stock was filed by *Louis Como.* This claim is based upon Certificate No. 7 for 4 shares dated February 2, 1953 and Certificate No. 42 for 2 shares bearing the same date. The stated consideration for the said shares is $6,000. Power of attorney runs to Michael Berman, Esq., 37 Wall Street, New York 5, New York.

Objections to the allowance of Louis Como Stock Claim No. 19 were filed by the debtor and by Ida Mae Margolis, et al. The debtor's objections were the usual ones, to wit, that Malakoff had no title to the stock transferred to Louis Como and that no consideration passed to Nazareth.

The objections of the Margolis group alleged that the claimant had paid no consideration for the stock either to Malakoff or Nazareth; that claimant's stock was completely unauthorized because it was issued after the 200 shares of Nazareth stock had already been issued; and that the
[fol. 104] debtor's objections to the stock claims of the Margolis group should be deemed incorporated in the Margolis objections to the stock claim of Louis Como. Notice of a hearing on the aforesaid objections was given to Louis Como by the Examiner. Notice was also given to

the debtor's attorney, and the attorney for the Margolis group. No notice was given to Michael Berman Esq. but claimant appeared in person and testified in support of his stock claim.

Claimant Louis Como first met Malakoff in about 1945 when Malakoff was a customer of a service station and garage operated by Como. He had no business transactions with Malakoff, however, until August 1951. At that time, Malakoff talked to claimant about investing in Farmers Market and claimant visited the market on four different occasions. Malakoff told Como that the market belonged to him and he told claimant that he would get 20% return on his investment in the market.

According to claimant, he went to Malakoff's office in August 1951 and gave Malakoff $4,000 in cash for Nazareth stock. His brother, Frank, went with him and his brother also gave Malakoff $4,000 in cash for Nazareth stock. Louis Como testified that he obtained the $4,000 in cash that he gave to Malakoff by withdrawing $3,000 on February 19, 1951 from a savings account in the National City Bank of New York, and by using $200 in cash that he had in his home and $800 that he obtained from another source. The claimant's bank book with the National City Bank was produced and that reflects a withdrawal of $3,000 on Febru- [fol. 105] ary 19, 1951. Claimant testified that he kept this money at home until August 1951 when he gave it to Malakoff.

Claimant testified that he had another transaction with Malakoff towards the beginning of 1953. At that time he gave Malakoff $4,000 in cash for 2 shares of stock for himself and 2 shares for his brother, Frank. He got from Malakoff Stock Certificate No. 7 for 4 shares dated February 2, 1953 through the mails in a letter dated February 2, 1953, which letter he produced. Claimant's testimony was not entirely clear as to when he received the second Stock Certificate No. 42 for 2 shares. He testified that he got this stock certificate probably around the beginning of February or the end of January after he gave Malakoff an additional $2,000 but he also testified that the second purchase took place at the end of February or the beginning of March 1953.

Stock Certificate No. 7 is regular on its face. The stub for this certificate indicates that it was issued without any conditions or qualifications. Stock Certificate No. 42 for 2 shares, which is also dated February 2, 1953, contains an endorsement reading as follows:

> "This certificate represents two $1000— shares ($2000). At the present time the dividend is guaranteed at 20% per annum payable in equal monthly installments on the first day of each month. John Malakoff"

The stub for Certificate No. 42 is regular on its face and has no qualifications or conditions whatever written thereon.

[fol. 106] Louis Como testified that he received a series of 17 checks in the sum of $66.67 each signed by John Malakoff, Agent, or John Malakoff, Special, and drawn upon the Corn Exchange Bank Trust Company. The first of these checks is dated September 1, 1951 and the balance are dated on the first or second day of each and every month through January 1953. Some of the checks have the word "Nazareth" or the words "Nazareth, Pa." over the Como endorsement. Each check represents 1/12th of 20% per annum interest on $4,000. These checks tend to confirm the testimony of claimant that he actually gave Malakoff $4,000 in cash. It is doubtful that Malakoff would have paid the so-called dividends on $4,000 to Louis Como if he had not actually received $4,000 from him, whatever Malakoff might have done with some other claimant with whom he had many different transactions.

Louis Como testified that he did not receive checks for $66.67 each in February or March 1953. The Siegel, Berg & Company report on Nazareth dated August 21, 1953 lists Louis Como as having received a check for $66.67 dated February 2, 1953 and a check for the same amount dated March 2, 1953. Claimant admits that he received so-called dividend checks of John Malakoff dated April 1, 1953 and May 1, 1953 in the amount of $100 each drawn upon the Manufacturers Trust Company. These checks represent 1/12th of interest at the rate of 20% per annum on $6,000.

They support claimant's testimony as to the additional $2,000 given to Malakoff in February or March 1953. The May 1, 1953 check was cashed. It is certain that Louis [fol. 107] Como received the dividend checks for February and March 1953 which were drawn upon the bank account of Nazareth despite claimant's testimony to the contrary. Claimant would have insisted upon Malakoff paying the February and March dividends and undoubtedly would have refused to give Malakoff the additional $2,000 if those dividends had not been paid.

The debtor points out that the issue as to Louis Como's stock claim is whether he actually gave Malakoff $6,000 in cash for the purchase of 6 shares of stock. The debtor also calls attention to the vagueness of Louis Como's testimony as to the source of the $6,000 and to certain contradictions in his testimony. Despite the contradictions and vagueness it seems reasonably certain that Louis Como actually gave Malakoff $6,000 at some time for 6 shares of Nazareth stock. The business of Como was such that he easily could have accumulated $6,000 in cash. His testimony is not incredible. Claimant Louis Como received dividends totalling $1,466.73. There was no evidence in the record that during 1951, 1952 and 1953 Nazareth made sufficient net profit to justify the payment of dividends. These dividends therefore represented a return of capital by Malakoff. The sum of $4,533.27 constitutes the net fair value of Louis Como's investment in Nazareth.

46. Claim No. 18 for 6 shares of Nazareth stock was filed by *Frank Como*. This claim is based upon Certificate No. 9 for 4 shares and Certificate No. 41 for 2 shares. The consideration for the said stock is alleged to be $6,000. [fol. 108] Michael Berman, Esq. of 37 Wall Street, New York 5, New York, is designated as attorney in fact.

The debtor filed objections to the allowance of stock claim No. 18 on the ground that Malakoff did not own the stock that was issued to claimant and on the further ground that no consideration passed to Nazareth. Objections were also filed by the Margolis group on the ground that claimant paid no consideration to Malakoff or Nazareth for his stock, and upon the further ground that the stock issued

to claimant was in excess of the authorized capital stock of Nazareth. The Margolis group also attempted to incorporate the debtor's objections to the stock claims of the Margolis group as objections to the allowance of the stock claim of Frank Como. Notice of a hearing on the said objections was given by the Examiner to the claimant and other parties in interest. Notice was not given to Michael Berman, Esq. but claimant, Frank Como, appeared in person at the hearing on objections and offered testimony in support of his stock claim.

Frank Como met Malakoff for the first time in or around 1947 or 1948 through his brother, Louis. This was at Como's Gas Station where Frank Como customarily serviced Malakoff's car. Claimant took a trip with Malakoff to Nazareth early in August 1951. According to claimant, on August 14, he and his brother, Louis, went to Malakoff's office and each had $4,000 in cash. Frank Como gave Malakoff $4,000 and obtained a receipt for that money. Helen Bernstein and Malakoff's secretary were both present in Malakoff's office at the time. Frank Como was made to un- [fol. 109] derstand that he was buying shares in the Farmers Market not in a corporation or a partnership, and that he was paying $1,000 per share.

Frank Como testified that thereafter, and in January 1953 or possibly December 1952, he gave Malakoff $2,000 in cash for 2 additional shares of Nazareth stock. He did not get a receipt from John Malakoff for this $2,000 in cash. Later he got the 2 stock certificates, No. 9 and No. 41.

Frank Como produced a letter from Malakoff to him dated August 14, 1951. This letter states that Malakoff is holding $4,000 in escrow for which Frank Como holds 4 shares of Nazareth stock in escrow. These shares, so the letter states, "will represent at the present time a twenty-per-cent per annum return on your (Frank Como) investment, payable monthly." A footnote states that the 4 shares of stock will be forwarded to Frank Como "as soon as we (Malakoff) receive them." It also states that Como is to hold the shares "as security, in escrow, until the deal is consummated."

Frank Como further testified that he first received dividends on his Nazareth investment of $4,000 on or about September 1, 1951. This claimant undoubtedly received 17 checks of John Malakoff or John Malakoff, Special, drawn on the Corn Exchange Bank Trust Company for $66.67 each and payable on the first or second day of each month commencing with September 1951 and ending with January 1953. On three of these checks the word "Nazareth" appears over the endorsement of claimant. Each of these checks represents 1/12th of 20% per annum interest on [fol. 110] $4,000. Thus these checks, as well as the letter of August 14, 1951, tend to corroborate Frank Como's testimony that he actually gave Malakoff $4,000 in cash in August 1951.

The Siegel, Berg report discloses that Frank Como received $66.67 on or about February 2, 1953 and the same amount on or about March 2, 1953 from the Nazareth bank account in the Second National Bank. Frank Como also admits receiving a $100 check of John Malakoff dated April 1, 1953 and drawn upon the Manufacturers Trust Company. This check represents 1/12th of interest at the rate of 20% per annum on $6,000.

Stock Certificates No. 9 and 41 are regular on their face. Both certificates are dated the 2nd day of February 1953 and are signed by Jerome Fried, Secretary, and John Malakoff, President. Certificate No. 41 bears the following endorsement "This certificate represents two $1000. shares ($2000—). At the present time the dividend is guaranteed at 20% per annum payable in equal monthly installments on the first day of each month. John Malakoff." There is nothing upon the stubs of Stock Certificates No. 9 and 41 to indicate that they were subject to any conditions or qualifications.

The debtor states that the issue as to Frank Como is whether he actually gave $6,000 in cash to Malakoff for the purchase of 6 shares of Nazareth stock. The testimony of this witness as to the advance of $6,000 to Malakoff is not incredible and there is no reason why this testimony should be rejected. This claimant gave Malakoff $6,000 and re- [fol. 111] ceived a repayment thereof of $1,366.73. There is no evidence that any part of this $6,000 was turned over

to Nazareth but that is irrelevant in the light of the position taken by the Examiner. The evidence is clear that Frank Como, as well as his brother, Louis Como, gave their moneys to Malakoff for the express purpose of acquiring Nazareth stock.

The sum of $4,633.27 constitutes the net fair value of Frank Como's investment in Nazareth.

47. Claim No. 17 for 8 shares of Nazareth stock was filed by *Patsy Como*. This claim is represented by Certificate No. 37 for 6 shares and Certificate No. 38 for 2 shares. The stated consideration allegedly paid for such stock is $8,000. Michael Berman, Esq. is designated as attorney in fact.

Objections were filed to the allowance of Stock Claim No. 17 of Patsy Como by the debtor and the Margolis group on the same grounds set forth in the objections to the allowance of the stock claim of Frank Como. Notice of a hearing on the objections was given to Patsy Como and other parties in interest by the Examiner. Notice was not given to Michael Berman, Esq. but Patsy Como appeared and testified at the hearing on objections to the allowance of his stock claim.

Patsy Como testified that Louis Como acted for him in making an investment in Nazareth. In March 1953, Louis Como spoke to his brother, Patsy, and suggested that he make an investment in Nazareth. Louis Como then called Malakoff to find out how many shares his brother could purchase and he was told that he could have 6 shares. [fol. 112] According to Patsy Como, he gave his brother, Louis, $6,000 at his gas station in the presence of Helen Bernstein. Following that Louis Como went to Malakoff's office and give him the $6,000 and obtained a certificate for 6 shares. Patsy Como is undoubtedly truthful in stating that his brother gave Malakoff $6,000 for investment by him in Nazareth but that must have taken place in February or possibly in January 1953 because Certificate No. 37 for 6 shares is dated the 2nd day of February 1953. It is, of course, possible that Certificate No. 37 (as well as other certificates) had been dated long before Louis Como gave Malakoff the $6,000 in cash he had obtained from his

brother, in which event Patsy Como's testimony that he gave the money to his brother in March would be correct. Patsy Como did testify that he got Stock Certificate No. 37 around March 1953.

According to Patsy Como, he purchased 2 additional shares about thirty days after receiving Stock Certificate No. 37 for 6 shares. He claims that he gave Malakoff $2,000 in cash for the second purchase and then received Stock Certificate No. 38 for 2 shares. Patsy Como testified that prior to March 1953 he had approximately $15,000 or $18,000 in cash which he either kept in a savings account or used to purchase bonds. His recollection was that he cashed $8,000 in bonds and the moneys received were for a particular deal that was pending at the time and the deal apparently was never consummated. His story is that he put the moneys in a safe deposit box and did not touch those moneys until he used $6,000 to buy 6 shares of Nazareth stock.

[fol. 113] Patsy Como never lent any money to Malakoff or to Helen Bernstein. He also admitted that he did not issue any checks directly to Nazareth or make any direct payments to Nazareth for the purchase of stock.

Stock Certificates No. 37 and 38 are in the name of Patsy Como. Each certificate is dated the 2nd day of February 1953 and is regular on its face. Certificate No. 37 bears the following endorsement: "This certificate represents 6 one thousand dollars shares ($6000.00). This stock is guaranteed to earn a minimum of 20% per annum payable monthly. Therefore you will receive a check for one hundred dollars ($100.00), the first day of each month—John Malakoff." Certificate No. 38 has a somewhat similar endorsement signed by John Malakoff indicating that it represents $2,000 and is guaranteed to pay a minimum of 20% per annum in monthly payments of $33.34.

The stub for Certificate No. 37 has the word "void" written in ink thereof and then crossed out and the initials HB appear in pencil writing alongside of Patsy Como's name. The stub for Certificate No. 38 has the pencilled initials HB alongside Patsy Como's name. In all other respects the stubs seem to be regular and not subject to any conditions or qualifications. The initials HB probably stand

for Helen Bernstein and do not seem to have any real significance.

[fol. 114] Patsy Como produced a letter from the United States Treasury Department with an attached list of redeemed savings bonds in the name of Patsy Como which were cashed in 1951. This letter was introduced for the purpose of establishing the source of the cash funds that were used by Patsy Como to purchase the 8 shares of Nazareth stock. The Siegel, Berg report discloses that Patsy Como received a check for $133.33 on or about March 2, 1953 from the Nazareth account in the Second National Bank. This payment indicates that $8,000 must have been advanced by Patsy Como to Malakoff by February 1953. The report indicates that no payments were made to Patsy Como from the Nazareth bank account in February 1953. However, a check for $133.33 of John Malakoff to Pat Como dated April 1, 1953 and drawn upon the Manufacturers Trust Company was endorsed by Pat Como who undoubtedly received the cash therefor. In addition, Patsy Como testified that he received another check for $133.33, probably for May 1953, which was returned for insufficient funds and that his brother, Louis, collected approximately $60 on the check for Malakoff. $133.33 is 1/12th of interest at the rate of 20% per annum on $8,000. Patsy Como received in so-called dividends a total of $326.66 which actually represented a return of capital. No dividends were declared by Nazareth nor is there any evidence to indicate that sufficient moneys were earned by the company to justify the payment of dividends.

The issue as to stock claim of Patsy Como as posed by the debtor is whether $8,000 was actually given in cash by Patsy Como for the purchase of 8 shares of Nazareth [fol. 115] stock. Despite the contradictions in his testimony as to whether he ever went to Malakoff's office, Patsy Como had the resources with which to purchase 8 shares of Nazareth stock for $8,000 and there is sufficient evidence to indicate that he did so.

The sum of $7,673.34 constitutes the net fair value of Patsy Como's investment in Nazareth.

48. Claim No. 3 for 5 shares of Nazareth stock was filed by *Anne Bikales*. This claim is based upon Stock Cer-

tificate No. 16 dated the 2nd day of February 1953. Power of attorney runs to Jacob Weiswasser, Esq. The stated consideration for the said shares of stock is $5,000.

Objections to the allowance of Claim No. 3 were filed by the debtor and the Margolis group. The debtor's objections are the customary ones of no stock belonging to Malakoff and no consideration passing to Nazareth. The objections of the Margolis group attempt to incorporate the debtor's objections to the stock claims of the Margolis group as objections to the Bikales stock claim and also charge that claimant Bikales has failed to establish payment of $5,000 to Malakoff or anyone else. An answer to the objections was filed by claimant Bikales through Jacob Weiswasser, Esq., 261 Broadway, New York, New York. The objections were brought on for hearing by notice served by the Examiner upon stock claimant Bikales, Jacob Weiswasser, Esq., her attorney, and other parties in interest. Evidence adduced at the hearing on objections indicated that stock claimant Bikales on the 5th day of September 1957 had assigned her stock certificate to Alexander Fisher, her brother. Jacob Weiswasser, Esq., on behalf of Alexander Fisher, filed a reply to the debtor's [fol. 116] objection to the allowance of Stock Claim No. 3. This report addresses itself to the allowance of the stock claim itself without regard to the present ownership thereof.

Stock claimant Bikales became interested in Nazareth in July 1951 when she met Helen Bernstein and was invited to go with her to see the market in Nazareth. Claimant drove to Nazareth and back with Malakoff, Helen Bernstein and Harold Q. Masur, another stock claimant. Towards the end of July 1951, claimant made a second trip to Nazareth, this time in the company of Malakoff, Masur, Alexander Fisher, one Altman and Helen Bernstein. On this second trip Malakoff told claimant that stock in Nazareth costs $1,000 per share.

On August 30, 1951, claimant met Helen Bernstein for lunch and gave her $5,000 for an interest in Nazareth. Claimant received a receipt for the $5,000 signed by Malakoff and stating that she would have a 1/40th interest in the ownership of the market for her $5,000. The letter receipt also stated that Malakoff was holding the $5,000 in escrow

and that claimant would receive a 20% per annum return payable in monthly installments. The original of this receipt (photostatic copy being produced and marked in evidence) was returned to Malakoff at his request.

Stock claimant Bikales testified that she was given to understand she was buying stock in a corporation. In spite of this fact, she did not make out a check to the corporation but paid $5,000 in cash to Mrs. Bernstein. She obtained this $5,000 in cash from her brother, Alexander [fol. 117] Fisher, who had been keeping it for her in his safe deposit vault. According to Alexander Fisher, on the way back from Nazareth, Malakoff told Alexander Fisher that the value of the market was about $200,000 and that he was going to issue 200 shares of stock. Fisher says that he was present at a luncheon meeting between his sister and Helen Bernstein and that he brought $5,000 belonging to his sister and examined the receipt given to her by Helen Bernstein. He also said that the receipt was actually turned over to his sister on the day the money was given to Helen Bernstein, to wit, August 30, 1951. Neither he nor his sister had any deals with Malakoff other than Nazareth nor with Helen Bernstein. Fisher says that Malakoff represented to him that he, Malakoff, was president of the corporation and that he was selling stock of the corporation.

On the first or second day of each month starting with October 1951 and ending January 1953, stock claimant Bikales received a check for $83.34 of John Malakoff, Agent, or John Malakoff, Special, drawn upon the Corn Exchange Bank Trust Company. These checks represented so-called dividend payments on the Bikales investment in Nazareth. Several of the checks have the word "Nazareth" over the endorsement of the claimant Bikales. Stock claimant Bikales also received checks for $83.34 from the Nazareth Bank account in the Second National Bank in February and in March 1953. In addition, this claimant received two checks for $83.34 each from John Malakoff dated April 1, 1953 and May 1, 1953 drawn upon the Manufacturers [fol. 118] Trust Company. The fact that claimant Bikales actually gave Malakoff $5,000 in cash seems to be confirmed by these so-called dividend payments each of which repre-

sented 1/12th of interest at the rate of 20% per annum on $5,000. It is clear that claimant Bikales knew that she was not buying stock from the corporation and it is doubtful, in the light of the receipt given to her by Malakoff, that she knew of the existence of a corporation.

Stock claimant Bikales produced what purports to be a copy of a letter sent to Malakoff on February 6, 1953. This letter was intended to reply to a letter dated February 2, 1953 from Malakoff to claimant in which he enclosed Stock Certificate No. 16 for 5 shares dated the 2d day of February 1953 and requested the return of the previous letter agreement. The letter of February 6, 1953 contained the statement by claimant that the return of the letter receipt of August 30, 1951, so far as Bikales understood it, "does not alter my investment insofar as percentage of ownership and amount of return."

The stock certificate issued to claimant Bikales is regular on its face. The stub for the stock certificate is likewise regular on its face and contains no conditions or qualifications.

The debtor states that the issue of fact to be determined in relation to the claim of Anne Bikales is whether $5,000 in cash was actually paid by Anne Bikales, as she contends was done. The evidence is convincing that the cash was in [fol. 119] fact paid. The total in so-called dividend payments to claimant Bikales is $1,666.80. Accordingly, the sum of $3,333.20 constitutes the net fair value of claimant Bikales' investment in Nazareth.

49. Claim No. 13 for 2 shares of Nazareth stock was filed by *Lawrence Treat*. This claim is based upon Certificate No. 17 dated the 2nd day of February 1953. The stated consideration for the issuance of such stock is $2,000 represented by claimant's check for that amount to the order of Malakoff dated September 11, 1951. Power of attorney runs to Harold Q. Masur, 520 East 20th Street, New York City.

Objections to the allowance of Claim No. 13 were made by the debtor and by the Margolis group. The former objected on the ground that Malakoff did not own the stock that was given to Treat and that no consideration passed to

Nazareth. The latter objected claiming that the objections of the debtor to the stock claims of the Margolis group should be deemed objections to the allowance of the Treat stock claim. The objections were brought on for hearing by the Examiner by notice given to stock claimant Treat and other parties in interest. Notice was not given to Harold Q. Masur as attorney in fact for Treat but Treat appeared in person at the hearing on the objections to his stock claim and Harold Q. Masur appeared at the hearing on the objections to the allowance of his stock claim.

Stock claimant Treat first met Malakoff at Malakoff's office in New York City on September 11, 1951. Claimant went to Malakoff's office with his wife and expressed a desire to invest in Nazareth. Claimant told Malakoff that [fol. 120] he had heard about Nazareth and Malakoff described the proposition in very glowing terms. He told Treat that stock certificates were not yet available. Treat gave Malakoff a check for $2,000 dated September 11, 1951 drawn upon the First National Bank of Croton-on-the-Hudson. Endorsed on the back of this check is the following: "Re Nazareth Farmers & Auction Market, Nazareth, Pa.—2/200ths interest." This check was endorsed John Malakoff and John Malakoff, Agent and deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Treat received a letter from Malakoff dated September 11, 1951 acknowledging receipt of his $2,000 check and stating that Malakoff was holding the check in escrow for "2 200ths of the Nazareth Farmers & Auction Market Nazareth Pennsylvania." This letter also stated that the return on Treat's investment would be 20% per annum payable monthly and that as the income increased the return would increase proportionately. The original of this letter was returned to Malakoff at his request at a subsequent time and a copy thereof was retained by Treat.

Treat testified that he received 18 so-called dividend checks in connection with the Nazareth transaction. Each check was in the amount of $33.34 and except for one check of Nazareth dated February 2, 1953 and drawn upon the Second National Bank, all of the checks were signed by John Malakoff, Agent, John Malakoff, Special, or John Malakoff. The agent and special account checks were drawn

upon the Corn Exchange Bank Trust Company and the John Malakoff checks, two in number, were drawn upon the [fol. 121] Manufacturers Trust Company. These were monthly checks running from November 1953 through May 1953, except for March 1953. Treat also received a Nazareth check on the Second National Bank for $33.34 for the so-called dividend due in March 1953. Thus Treat received in all 19 checks for $33.34 each for a total of $666.80. Each check was equal to 1/12th of interest at the rate of 20% per annum on $2,000.

Treat testified that the February 1953 check of Nazareth drawn on the Second National Bank failed to clear that bank and was returned for insufficient funds. Nevertheless, the Siegel, Berg report discloses that two checks for $33.34 each were given to Lawrence Treat on or about March 2, 1953 and presumably cleared the bank. Therefore the unpaid February check was made good by a March check, the proceeds of which undoubtedly were received by Treat.

Treat had one other financial transaction with Malakoff involving the Hotel Margaret. He admitted that he had not given any consideration directly to Nazareth. He also testified that Malakoff told him on September 11, 1951 that stock would be issued and when it was issued Treat would receive a certificate. In the meantime, he was given the letter receipt. Treat did not ask Malakoff any questions about the operations or financial set-up or control of the company prior to the purchase of his stock. Treat, with Masur acting as his attorney in fact, made an assignment of his stock to Blanche Waldman but that is irrelevant [fol. 122] here. Stock Certificate No. 17 was mailed to Treat by Malakoff in a letter dated February 2, 1953 which requested the return of the original letter agreement. The stub for Stock Certificate No. 17 is regular on its face with no conditions or qualifications attached thereto.

It is clear that Lawrence Treat gave Malakoff $2,000 for investment in Nazareth. It is questionable that this money was advanced to Malakoff for the purpose of acquiring stock but that is not important. Treat received a return of capital in the amount of $666.80. Accordingly, the sum of $1,333.20 constitutes the net fair value of Treat's investment in Nazareth.

50. Claim No. 20 for 3 shares of Nazareth stock was filed by *Dorothy Kane*. This claim was based upon Certificate No. 19 for 3 shares dated the 2nd day of February 1953. No attorney in fact is designated.

The debtor objected to the allowance of Stock Claim No. 20 on the ground that Malakoff did not own the stock issued to the claimant and on the further ground that no consideration passed to Nazareth. Dorothy Kane filed a reply to the objections of the debtor in which, among other things, claimant asked to be allowed a money claim if the stock claim was held to be invalid. The stock of Dorothy Kane was subsequently transferred to Robert H. Davidson, and he filed a reply to a so-called counterclaim in the debtor's answer which asserted that if the stock claim of Dorothy Kane was sustained, she was indebted to Nazareth in the sum of $3,000, the unpaid subscription price. The so-called counterclaim was incorporated in substantially [fol. 123] all of the objections filed but has not been considered because of the findings and conclusions of the Examiner. Notice of a hearing on the debtor's objections was given to Dorothy Kane, the attorney for Davidson, Assignee, and other parties in interest by the Examiner.

Dorothy Kane met Malakoff in the winter of 1951. A friend, by the name of Mrs. Long, in July or August 1951 suggested that she buy stock in Nazareth and in July or August 1951, Dorothy Kane sent Malakoff a check for $2,000. This must have happened in September 1951 because claimant produced photostatic copy of a check of the Ridgewood Savings Bank for $2,000 dated September 18, 1951 payable to the order of John Malakoff. This check was endorsed John Malakoff and John Malakoff, Agent and was deposited in the Agent account in the Corn Exchange Bank Trust Company. Over Malakoff's endorsement appears the word "Nazareth".

After mailing the $2,000 check to Malakoff, claimant visited the Nazareth market with Malakoff and at his instance. The invitation came to her through Mrs. Long who accompanied her on the trip to Nazareth. This trip must have been made some time between September 18 and November 2, 1951.

On November 2, 1951, claimant sent Malakoff a check for $1,000 in order to purchase one additional share of stock. That this was done is evidenced by photostatic copy of a check for $1,000 of the Ridgewood Savings Bank dated November 2, 1951 payable to the order of John Malakoff. This check was endorsed John Malakoff and John Malakoff, Agent and deposited in the Agent account in the Corn Ex-
[fol. 124] change Bank Trust Company. In September 1951 claimant bought the stock because she relied upon the representations made by her friend. At that time she had not met Malakoff and had no personal knowledge of him. She relied upon the representations of her friend that Malakoff had an interest in Nazareth. When she met Malakoff, he did not tell her that he was President of Nazareth. When they drove to Nazareth, Malakoff told claimant that he owned the Nazareth Fairgrounds & Farmers Market, Inc. On the way down to the market in the car, claimant was led to believe that Malakoff owned all of the stock but this came out in casual conversation and she could not recall whether such a statemen' was made by Malakoff himself.

Dorothy Kane was given a receipt dated September 18, 1951 covering her initial investment of $2,000. This receipt in the form of a letter addressed to Dorothy Kane, recited that all of the authorized stock of Nazareth Farmers & Auction Market, Inc. which owned the market, had been issued to Malakoff. In this letter, Malakoff told claimant that he might cause to be issued to her 2 shares of his "present stockholdings". On the other hand, he might dissolve the corporation and arrange for the formation of a limited partnership in which she would be a limited partner and her $2,000 would be applied as her contribution with a corresponding proportionate interest. In a postscript to the letter, Malakoff stated that there were 200 shares issued and that Dorothy Kane would have 1/100ths of the deal. Dorothy Kane also received a letter acknowl-
[fol. 125] edgment of the receipt of the additional $1,000. This letter is dated November 1, 1951 and is substantially the same as the letter dated September 18, 1951 except that it applies to $1,000 and one share or 1/200ths interest in the venture.

The actual stock certificate was received by claimant on or about February 2, 1953. The certificate is regular on its face and has no qualifications or conditions. The stub for Certificate No. 19 is likewise regular on its face. Claimant received from Malakoff a check of John Malakoff, Agent, for $16.67, dated October 1, 1951. Over the endorsement of Dorothy Kane appears the following: "Nazareth up to 10/1 51." In addition, a check for $33.34 of John Malakoff, Agent drawn upon the Corn Exchange Bank Trust Company, as was the check for $16.67, was made payable to "Dorothy" and was endorsed as follows: "Nazareth, Dorothy, and M. S. Sternberg". This check was deposited in the Public National Bank & Trust Company. There seems to be no evidence that this check was actually given to or received by Dorothy Kane. None of the checks subsequently given to Dorothy Kane was deposited in the Public National Bank & Trust Company or bears the endorsement of M. S. Sternberg. The endorsement on this check seems to be unlike the endorsement of Dorothy Kane on other checks. Furthermore, it is doubtful that Malakoff would have given Dorothy Kane two separate checks, both dated October 1, 1951. A check of John Malakoff, Agent for $33.34 payable to the order of Dorothy Kane dated November 1, 1951 and endorsed Dorothy Kane was undoubtedly received by her and represented a so-called divi- [fol. 126] dend on her Nazareth investment. At that time the investment was $2,000. Between December 1951 and January 1953 each month on the first or second days a check of John Malakoff, Agent or John Malakoff, Special for $50 was issued to claimant and received by her. In February and March 1953, claimant received a check each month for $50 of Nazareth drawn on the Second National Bank of Nazareth. Claimant also received a check in April 1953 and one in May 1953 of John Malakoff drawn upon the Manufacturers Trust Company, each for $50. These $50 checks represented so-called monthly dividend payments on an investment of $3,000 at the rate of 20% per annum. Claimant received a so-called dividend check for June 1953 but that check was returned unpaid because it was drawn against uncollected funds. The total received by Dorothy Kane in so-called dividends was $950.01.

There can be no doubt about the investment of $3,000 by Dorothy Kane in the Nazareth enterprise. The sum of $950.01 was returned to her. Accordingly, the sum of $2,049.99 constitutes the net fair value of Dorothy Kane's investment in Nazareth.

51. Claim No. 34 for 4 shares of Nazareth stock was filed by *Miriam Klein*. This claim is represented by Certificate No. 22 for 4 shares. The stated consideration for the said stock is as follows: "Payment of $4,000.00 to John Malakoff, president of the debtor, for the purchase of four (4) shares of stock of the debtor corporation, said purchase being made in two transactions, one on Sept. 21, 1951, and second on about Feb. 1, 1953, for which Stock [fol. 127] Certificate No. 22 in the amount of four shares of the Debtor Corporation was issued to claimant on the second day of February, 1953 and signed by John Malakoff, President, and Jerome Fried, Secretary." No attorney in fact was designated.

Objections to the allowance of Miriam Klein Stock Claim No. 34 were filed by the debtor. These objections alleged that Malakoff did not own the stock that was issued to the claimant, and that no consideration passed to Nazareth. The objections also included a counter-claim that claimant pay $4,000 if her stock claim was sustained. Notice of a hearing on the debtor's objections was given to stock claimant Miriam Klein and to the attorney for the debtor.

Miriam Klein met Malakoff prior to September 1951 at the home of her mother-in-law, Gertrude Klein. At this meeting, Malakoff told Mrs. Klein that the Nazareth market was a good deal and if she made an investment in the market she would receive a 20% return. Miriam Klein on September 17, 1951 gave Malakoff a check for $1,200 payable to his order and drawn upon the Mount Vernon Trust Company. This check was endorsed John Malakoff and John Malakoff, Agent, and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Over the endorsement is the word "Nazareth". Mrs. Klein received from Malakoff a letter receipt dated September 21, 1951 at the bottom of which the following appeared: "1 100th of deal". The letter itself acknowledged receipt of a check without the amount thereof being stated, and re-

ferred to the possibility that Malakoff might cause to be [fol. 128] issued to Miriam Klein 2 shares of his then present stockholdings. A 1/100ths interest would represent an investment of $2,000 at $1,000 per share and $1,200 at $600 per share. There is no evidence that anything more than $1,200 was given to Malakoff by Mrs. Klein in September 1951.

On June 9, 1952, Bernard Klein issued a check for $1062.50 to John Malakoff and on July 18, 1952 a check for $1087.50. Both of these checks were endorsed by John Malakoff and were deposited in the Irving Trust Company in an account of the Hotel Wales, Wales Properties Inc. According to the testimony, these checks were given to Malakoff on behalf of Miriam Klein for the purpose of investment in real estate transactions. A profit of $100 was made on the first investment and a profit of $250 on the second. Thereafter there was a third real estate investment with the moneys previously advanced to Malakoff, and a profit of $300 was realized. According to Mrs. Klein, Malakoff asked her and her husband, Bernard Klein, whether they would be interested in purchasing additional shares of stock in Nazareth with the moneys invested on June 9, 1952 and July 18, 1952 and the profit thereon. This happened approximately February 1, 1953. Mrs. Klein acquiesced in this proposal and thereafter she received a stock certificate for 4 shares of Nazareth stock. This Stock Certificate, No. 22, was mailed to Miriam Klein in February 1953.

The stub for Stock Certificate No. 22 is dated 2/2/1953. There is a notation "(see 6)" and the legend "out" appears thereon. The stub for Stock Certificate No. 6, as [fol. 129] hereinabove stated, bears the legends "option" and "out". It also appears that the figure 14, indicating the number of shares of the stock certificate, was written over another figure. Gertrude Klein is the mother of Bernard Klein, husband of Miriam Klein. The connection between Certificates Nos. 6 and 22 is not at all clear.

No other written memorandum was received by Miriam Klein from John Malakoff at any time, that is with regard to Nazareth. Miriam Klein testified that other than the $1200 check of September 17, 1951 and the two checks of her husband dated June 9, 1952 and July 8, 1952, no other

checks were given to Malakoff or to any corporation with which he was connected. This testimony was corrected to indicate that the Kleins had another transaction with Malakoff in regard to the Hotel Margaret in Brooklyn. Bernard Klein produced four additional checks payable to Malakoff, all drawn on the Mount Vernon Trust Company and all endorsed by John Malakoff and John Malakoff, Agent, and deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. These checks were January 11, 1952, $5,000; January 11, 1952, $750, February 27, 1952, $1,000 and March 14, 1952, $2200. The check for $1,000 has the words "Hotel Margaret" over the endorsement of John Malakoff and the check for $750 has the words "Re 541 W. 13th St." which were crossed out. Miriam Klein testified that she and her husband gave Malakoff a total of $6,000 for investment in the Hotel Margaret and a letter receipt for $6,000 from Malakoff to Bernard Klein dated March 18, 1952 was produced and marked in evidence. [fol. 130] Mrs. Klein received a series of fifteen checks for $20 each signed John Malakoff, Agent, or John Malakoff, Special, and drawn upon the Corn Exchange Bank Trust Company. The first of these checks is dated November 1, 1951 and the last January 2, 1953. There is a check for each intervening month. On one of these checks the word "Nazareth" appears over the endorsement of M. Klein. Each check is 1/12th of 20% interest per annum on $1200. Two checks for $66.67 each were given to Miriam Klein in February and March 1953 from the Nazareth account in the Second National Bank of Nazareth, Pennsylvania. The sum of $66.67 represents 1/12th of interest at the rate of 20% per annum on $4,000. These checks support Miriam Klein's testimony that the moneys given to Malakoff for investment in June and July 1952 which totalled $2150 plus the alleged profit on the three real estate investments were retained by Malakoff and applied for an additional investment on behalf of Miriam Klein pursuant to agreement of the parties made on or about February 1, 1953. The claimant also testified that she received two checks for $66.67 each of John Malakoff drawn on the Manufacturers Trust Company, one dated April 1, 1953 and the other April 30, 1953 which represented additional

so-called dividend checks on her investment of $4,000 in Nazareth stock. These checks were marked in evidence. Thus claimant received a total of $566.68.

Miriam Klein testified that neither she nor her husband at any time lent any money to Malakoff. She was confronted with a number of checks of John Malakoff, Agent payable to her order, some for $500 and others for $250 but [fol. 131] she could not explain what these checks represented. These checks were deposited in her bank accounts. Her husband was employed by Malakoff and was the manager of the Hotel Wales for about two years. Her husband did get some dividend checks for $100 each in connection with his investment in the Hotel Margaret.

The testimony of both Miriam Klein and her husband, Bernard Klein, is to the effect that the first two shares of Nazareth stock were sold to Miriam Klein at $600 per share. They also testified that the additional two shares were sold to them for $1400 per share. Bernard Klein testified that the $500 and $250 checks which his wife could not identify, represented a return of moneys that had been given to Malakoff for the purpose of investing in the Hotel Margaret.

The debtor points out that the testimony of Miriam Klein and her husband, Bernard Klein, is contradictory. The debtor contends that they apparently were engaged in usurious transactions with Malakoff. The testimony of claimant and her husband is contradictory and a clear explanation has not been given with respect to the checks received from Malakoff. Nevertheless, it appears reasonably certain that Miriam Klein at least gave Malakoff the three checks, that is those of September 17, 1951 for $1200, June 9, 1952 for $1062.50 and July 18, 1952 for $1087.50 which ultimately were invested in Nazareth. It may be true that Malakoff told Mrs. Klein that she had made a profit of $650 in all on three real estate transactions which would be applied to Nazareth stock but there is insufficient [fol. 132] evidence to support the existence of a profit in fact. It is true that Malakoff did not ordinarily pay dividends on moneys not actually received by him but it is reasonable to believe that he was willing to pay dividends on an additional $650 in order to be able to retain the aggre-

gate of the checks for $1062.50 and $1087.50. It is also hard to believe that Miriam Klein, whose husband had been employed by Malakoff, would pay $1400 a share for Nazareth stock in January or February 1953, at a time when he was selling the stock for $1,000 per share to others, and particularly after having purchased Nazareth stock from him for $600 per share. Miriam Klein should be credited with an investment representing the aggregate of the three checks or a total of $3,350. She received a return of capital by way of so-called-dividend payments in the sum of $566.68. Accordingly, the sum of $2,783.32 constitutes the net fair value of Miriam Klein's investment in Nazareth.

52. Claim No. 36 for 3 shares was filed by *Ruth Spielholz* based upon Certificate No. 21 dated the 2nd day of February 1953. The proof of debt states that the stock was purchased in two transactions, one on September 19, 1951 and the other on January 26, 1953.

Objections to the allowance of the claim of Ruth Spielholz were filed by the debtor on the ground that Malakoff had no title to the stock which was issued to her and on the further ground that no consideration passed to Nazareth. Notice of hearing on the objections was given by the Examiner to the claimant and the debtor.

[fol. 133] It appears that Malakoff was a friend of Mrs. Spielholz' family for many years. Mrs. Spielholz is related to Gertrude and Miriam Klein, other stock claimants in this proceeding. In September 1951, claimant saw Malakoff and his sister, Alice Malakoff. At that time Malakoff spoke about Nazareth and a week or two thereafter, having talked it over with her husband, Mrs. Spielholz sent Malakoff a check for $1200. This check was drawn on the Mount Vernon Trust Company, was dated September 19, 1951 and was endorsed John Malakoff and John Malakoff, Agent. The check was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Over the endorsement of John Malakoff appears the word "Nazareth".

At the first meeting in September 1951, Malakoff told Mrs. Spielholz and her husband that they would get a return of 20% on their investment. He did not mention whether he owned the business or whether they would

receive evidence of their ownership in the form of stock certificates or whether they were going to be partners in the business. Thereafter, and in January 1953, Ruth Spielholz sent Malakoff a check for $1800 for an additional investment in Nazareth stock. This check was dated January 26, 1953, was made payable to John Malakoff and was endorsed by him and deposited in an account in the New York Trust Company. This second check was sent to Malakoff as the result of a telephone call from him to claimant's husband in which her husband was told that Malakoff was going to issue shares and that he would send three shares in Nazareth corporation upon receipt of an additional $1800. Stock Certificate No. 21 was sent to Mrs. Spielholz.

[fol. 134] Mrs. Spielholz did not have any other transactions with Malakoff nor did her husband. She did not lend Malakoff any money nor receive any checks from him. Malakoff never repaid Mrs. Spielholz the amount of her investment in Nazareth.

Mrs. Spielholz received a check for $6.67 of John Malakoff, Agent dated October 1, 1951 and drawn upon the Corn Exchange Bank Trust Company. This check was endorsed by Ruth Spielholz and over her endorsement appears the word "Nazareth". This check represented a pro-rata dividend upon the $1200 investment. Mrs. Spielholz also received fifteen monthly checks for $20 each of John Malakoff, Agent or John Malakoff, Special, running from November 1951 through January 1953. These were monthly dividend checks representing a 20% per annum return on $1200. She also received a $20 check dated February 2, 1953 of Nazareth and a $50 check of Nazareth dated March 2, 1953 drawn upon the Second National Bank of Nazareth, Pennsylvania. The first check represented the February dividend on $1200 and the second check, the March dividend on $3,000. Mrs. Spielholz also received a check of John Malakoff for $50 dated April 1, 1953 drawn upon the Manufacturers Trust Company. Thus claimant received a total of $426.67.

Stock Certificate No. 21 is regular on its face. The stub for this certificate, however, has the legend "out" appearing thereon. No satisfactory explanation has been offered as to

the reason for the appearance of this word on the stock stub. Apart from this factor, there is nothing in the record to indicate that Ruth Spielholz and Malakoff did not enter into a perfectly proper transaction under which Ruth Spielholz agreed to buy and Malakoff agreed to sell three shares [fol. 135] of Nazareth stock. The sum of $3,000 was paid to Malakoff and claimant expected to get and did receive a stock certificate for 3 shares. No part of the consideration has been traced to Nazareth but that is not important in the view the Examiner has taken of the situation. Accordingly, the sum of $2,573.33 constitutes the net fair value of the investment of Ruth Spielholz in Nazareth.

53. Claim No. 4 for 2 shares of Nazareth stock was filed by *Mae Bluestone* based upon Stock Certificate No. 24 dated the 2nd day of February 1953. The proof of debt states that $2,000 was paid for the stock and it contains a power of attorney running to Jacob Weiswasser, Esq.

Objections to the allowance of the stock claim of Mae Bluestone, No. 4, were filed by the debtor and by Benjamin Margolis, et al. The objections of the debtor were that Malakoff had no title to the certificate issued to claimant and no consideration passed to Nazareth. The objections of the Margolis group attempted to incorporate as objections to Stock Claim No. 27 the objections of the debtor to the allowance of the stock claims of the Margolis group. The debtor's answer also included a counterclaim for $2,000. Claimant replied to the debtor's objections claiming lack of jurisdiction in the court, Statute of Limitations and estoppel. Notice of hearing on the said objections was given by the Examiner to the claimant, her attorney in fact, and other parties in interest.

[fol. 136] Mrs. Bluestone met Helen Bernstein while visiting friends. Helen Bernstein spoke to her about Malakoff and about the stock in Nazareth that he was selling. Mrs. Bluestone visited Malakoff's office in October 1951 and discussed buying stock. She evidently agreed to buy 2 shares for $2,000 and gave Malakoff a check of Henry Bluestone for that amount dated October 31, 1951 drawn on the Manufacturers Trust Company, 711 Lexington Avenue, New York. This check was endorsed as follows: "2

shares Mae Bluestone Nazareth Farmers & Auction Market 1/100th share of business, John Malakoff, John Malakoff Agt." The check was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. The legend appearing over the Malakoff endorsement on the check was placed thereon by Mae Bluestone. She received a letter receipt from Malakoff when the check was delivered but she does not know what happened to that letter. Thereafter, and in a letter dated February 2, 1953, Stock Certificate No. 24 was forwarded to her. This letter requested the return of the letter agreement previously given to her.

Commencing on December 1, 1951 and monthly thereafter through January 1953, Mae Bluestone received a check for $33.34 of John Malakoff, Agent or John Malakoff, Special drawn upon the Corn Exchange Bank Trust Company. She also received a check dated February 2, 1953 for $33.34 and a check dated March 2, 1953 for $33.34 of Nazareth drawn upon the Second National Bank of Nazareth. In addition, she received a check of John Malakoff for $33.34 dated April 1, 1953 drawn upon the Manufacturers Trust Company. She also received checks for the same amount [fol. 137] of John Malakoff drawn upon the Industrial Bank of Commerce dated May 25, 1953 and June 4, 1953 but both of these checks were returned to her unpaid. Mrs. Bluestone visited the Nazareth market a few months after she purchased the stock.

Mrs. Bluestone did not have any other transactions with Malakoff. She does recall that when she went to Malakoff's office for her first appointment at which time she purchased the stock, Malakoff informed her that she would get a dividend of 20% and that the stock would cost $1,000 per share. In this first conversation, Mrs. Bluestone got the impression that Nazareth belonged to Malakoff. Concededly Mrs. Bluestone paid no money directly to Nazareth nor was any part of the consideration paid by her to Malakoff traced to Nazareth.

Stock Certificate No. 24 is regular on its face. The stub for that certificate contains no qualifications or conditions of any kind. Mrs. Bluestone advanced $2,000. She received in return of capital by way of so-called dividends the sum

of $566.78. Accordingly, the sum of $1,433.22 constitutes the net fair value of Mae Bluestone's investment in Nazareth.

54. Claim No. 33 for 2 shares of Nazareth stock was filed by *Gussie Schwartz* based upon Stock Certificate No. 30 dated the 2nd day of February 1953. The stated consideration is a check of Harold B. Schwartz to the order of Helen [fol. 138] Bernstein in the sum of $2,000 dated January 14, 1953 and endorsed "For investment in Nazareth Farmers Mkt. for 2 shares." Power of attorney runs to Bernard Buchwald, 16 West 46th Street, New York City.

Objections to the allowance of Stock Claim No. 33 of Gussie Schwartz were filed by the debtor on the ground that Malakoff had no title to the stock that was issued to claimant and on the further ground that no consideration passed to Nazareth. The debtor also pleaded a counterclaim for $2,000, the unpaid subscription price. Notice of a hearing on said objections was given by the Examiner to claimant and the attorney for the debtor. Harold Schwartz, son of Gussie Schwartz, appeared at the hearing on objections on behalf of claimant and testified that he acted with authority from his mother in the acquisition of 2 shares of Nazareth stock.

According to Harold Schwartz, he gave Helen Bernstein a check for $2,000 for the purchase of 2 shares of Nazareth stock at a reception given by Helen Bernstein at the Waldorf on January 14, 1953. The check, he said, was made payable to Helen Bernstein at her request. He produced the check for $2,000 which is dated January 14, 1953 and bears the following endorsement "For investment in Nazareth Farmers Mkt. for 2 shares Gussie Schwartz, Helen Bernstein, ok for cash M. S. Sternberg." Harold Schwartz also testified that at the time the $2,000 check was given to Helen Bernstein he received Stock Certificate No. 30 issued in his mother's name. It is doubtful that he got the stock certificate at that time since the certificate is dated the 2nd day of February, 1953. However, he apparently got [fol. 139] the long form of letter receipt given by Malakoff to some of the Nazareth investors. This receipt was dated January 14, 1953 and acknowledged receipt of check for

$2,000 for which Malakoff might cause "to be issued to you (Gussie Schwartz) 2 shares of my (Malakoff's) present stockholdings." As a matter of fact, this receipt seems to have been given to Harold Schwartz in duplicate with the view of having his mother sign a copy thereof and return the same to Malakoff. There is nothing in the record to indicate that the $2,000 actually was received by Malakoff but the record clearly shows that Helen Bernstein was acting as Malakoff's agent in the sale of Nazareth stock and the letter receipt signed by Malakoff tends to support this conclusion.

Stock Certificate No. 30 is regular on its face, as is the stub for this certificate. There is nothing either on the certificate or the stub which indicates that the stock was issued subject to any conditions or limitations.

Harold Schwartz testified that his mother, Gussie Schwartz, received five so-called dividend checks, the last two of which were uncollectible. The first check seems to have been a Nazareth check for $16.67 dated February 2, 1953 and drawn upon the Second National Bank of Nazareth, Pennsylvania. On or about March 2, 1953, a Nazareth check for $33.34 drawn on the same bank was issued to Gussie Schwartz and undoubtedly was honored when presented. Gussie Schwartz also received a check for $33.34 dated April 1, 1953 drawn on the Manufacturers Trust Company. Claimant produced a check of John Malakoff [fol. 140] dated June 4, 1953 in the sum of $33.34 drawn upon the Industrial Bank of Commerce which was returned unpaid for insufficient funds. Claimant did not produce an unpaid check for May 1953 in the amount of $33.34 but on the basis of the testimony of Harold Schwartz claimant received a check for that month's dividend, which, however, was not honored when presented for payment. Therefore the total of the so-called dividends which claimant received is $83.35.

It is conceded that Gussie Schwartz paid no money directly to Nazareth for her Nazareth stock certificate. The record also fails to establish that the $2,000 given to Helen Bernstein by Gussie Schwartz ultimately found its way into the Nazareth bank account. Nonetheless, this claimant invested $2,000 with Malakoff for the specific purpose of buy-

ing Nazareth stock. She received by way of return of capital $83.35. Accordingly, the sum of $1,916.65 constitutes the net fair value of Gussie Schwartz' investment in Nazareth.

55. Claim No. 21 for 4 shares of Nazareth stock was filed by *Harold B. Schwartz* based upon Stock Certificate No. 29 dated the 2nd day of February 1953. The stated consideration for this stock is as follows: claimant's check for $2,000 dated July 23, 1952 to the order of John Malakoff and claimant's check dated January 14, 1953 to the order of Helen Bernstein in the sum of $2,000. The power of attorney runs to Bernard Buchwald, Esq.

Objections to the allowance of Stock Claim No. 21 of Harold Schwartz were filed by the debtor and by the Margolis group. The debtor's objections were similar to those interposed to the allowance of the claim of Gussie [fol. 141] Schwartz. The objections of the Margolis group charged that the stock acquired by claimant was stock sold by Malakoff in excess of the authorized issue of 200 shares. These objections also attempted to incorporate as objections to the claim of Harold B. Schwartz, the objections made by the debtor to the allowance of the claim of the Margolis group. Notice of a hearing on the said objections was given by the Examiner to the claimant and the attorney for the debtor. Claimant appeared in person at the hearing on the objections.

Harold B. Schwartz visited the Farmers Market on July 23, 1952 with Harold Q. Masur and was shown around the market by Masur and Malakoff. He spent the entire day at the market. He drove down and back in Malakoff's car. On the way back in answer to an inquiry addressed to Malakoff, he was told that stock in the market would cost $1,000 per share. Claimant told Malakoff that he would take two shares in the market and he was instructed to make the check to John Malakoff. Claimant produced a check for $2,000 made by him payable to the order of John Malakoff dated July 23, 1952. The endorsement on this check reads as follows: "Investment for Nazareth Farmers Market John Malakoff, John Malakoff, Agt." This check was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company.

At or shortly after the time claimant gave Malakoff his check for $2,000 he received in duplicate the long form letter receipt signed by Malakoff and acknowledging receipt of $2,000. He was requested to sign the duplicate and return it to Malakoff but he did not do so. This letter receipt re-
[fol. 142] ferred to the possible issuance by Malakoff to claimant of two shares of Malakoff's "present stockholdings."

Harold Schwartz testified that on January 14, 1953 he did purchase two additional shares of stock for himself and also two shares for his mother, Gussie Schwartz. He said that he had met Helen Bernstein, at a few social occasions and at a party which she gave, through Harold Masur, some time in 1952 or 1953. He was informed that Helen Bernstein was a secretary for or agent of Malakoff. He saw Miss Bernstein at her suite in the Waldorf and asked her if he could purchase four additional shares of Nazareth stock, presumably two for himself and two for his mother. He issued a check to Helen Bernstein dated January 14, 1953 in the sum of $2,000. The endorsement on this check is as follows: "For investment in Nazareth Farmers Mkt. for 2 shares Harold B. Schwartz, Helen Bernstein, ok for cash M. S. Sternberg." This check was evidently cashed by Helen Bernstein. There is nothing in the record showing that this money reached Malakoff or Nazareth. Nevertheless, Helen Bernstein was acting as the agent for Malakoff in the sale of Nazareth stock and a receipt that Harold Schwartz got for his $2,000 check is dated January 14, 1953 and is signed by Malakoff.

Stock Certificate No. 29 for 4 shares was sent to claimant by Malakoff in a letter dated February 2, 1953. There is nothing on this certificate nor on the stub therefor which indicates that the stock was issued to claimant subject to any conditions or qualifications.

[fol. 143] Claimant received a check for $8.33 dated August 1, 1952 signed John Malakoff, Special. This check apparently represented the accrued dividend on the investment of $2,000 that claimant had made with Malakoff on July 24, 1952. In September, October, November and December 1952 and January 1953, claimant received checks of John Malakoff, Special for $33.34 each. The word "Naz-

areth" appears over the endorsement on one of these checks. Each check is 1/12th of interest at the rate of 20% per annum on $2,000. Claimant also received a check for $66.67 of John Malakoff drawn on the Manufacturers Trust Company dated April 1, 1953. In addition, a check for $66.67 dated March 2, 1953 was issued to Harold Schwartz by Nazareth and drawn upon its account in the Second National Bank of Nazareth. Claimant produced a Nazareth check for $50 dated February 2, 1953 payable to him and drawn upon the Second National Bank of Nazareth which was returned because of insufficient funds, and a check for $66.67 of John Malakoff dated June 4, 1953 drawn upon the Industrial Bank of Commerce which was likewise returned for insufficient funds. Claimant testified that he received monthly checks until April 1, 1953 and that he received no payments other than those which were marked in evidence. It would therefore appear that claimant did not receive a dividend in May 1953. The total dividends received by claimant is $308.37.

Claimant gave to Malakoff, either directly or indirectly, the sum of $4,000 for investment in Nazareth. Claimant [fol. 144] acted in good faith. The sum of $308.37 was returned to claimant. Accordingly, the sum of $3,691.63 constitutes the net fair value of Harold B. Schwartz' investment in Nazareth.

56. Claim No. 30 for 2 shares of Nazareth stock was filed by *Lazar Karapontso* based upon Certificate No. 39 dated the 2nd day of February 1953. Power of attorney runs to Bernard Buchwald, Esq. The stated consideration for the stock is a check of the Central Savings Bank in the sum of $1,000 dated November 10, 1952 payable to John Malakoff and the sum of $1,000 in cash allegedly paid to Malakoff on or about November 12, 1952.

Objections to the allowance of Claim No. 30 were filed by the debtor and by the Margolis group. The debtor's objections were similar to those asserted against the allowance of the stock claim of Gussie Schwartz. The objections of the Margolis group attempted to incorporate as objections to the Karapontso stock claim objections filed to the allowance of stock claims of the Margolis group. In addi-

tion, the Margolis group charged that Karapontso had failed to establish the payment to Malakoff of $1,000 in cash. The hearing on the said objections was brought on by the Examiner on notice to claimant, Bernard Buchwald, Esq., the attorney for the debtor and the attorney for the Margolis group.

Karapontso learned about the Nazareth market in the early part of 1952 through two of his friends, Masur and Clark. A couple of months after his first conversation with them, Karapontso and Clark drove to Nazareth. Clark told him that he had invested in Nazareth at the rate of $1,000 per share and was receiving a dividend of 20% on his in- [fol. 145] vestment. Later, in the Spring or Summer of 1952, Masur introduced Mrs. Bernstein to Karapontso. In December 1952, Karapontso and Clark went to Malakoff's office at which time Karapontso purchased two shares of Nazareth stock.

Karapontso gave Malakoff a check of the Central Savings Bank for $1,000 dated November 10, 1952, which was endorsed John Malakoff and John Malakoff, Agent, and deposited in the Agent account in the Corn Exchange Trust Company. Karapontso was given a receipt by Malakoff and was told to keep the receipt until he received his stock certificate. Karapontso no longer has that receipt. Karapontso received from Malakoff Stock Certificate No. 39 dated the 2nd day of February, 1953. On the reverse side of this certificate, the following appears: "This represents two—one thousand shares ($2,000.00). You will receive 20% dividend per annum, payable in equal monthly payments of thirty-three .34 (33.34) on the first day of each month." The stub for Certificate No. 39 is regular on its face and does not show that the stock was issued subject to any limitations or conditions.

Karapontso claimed that he had given Malakoff $1,000 cash at the time he gave him the $1,000 check issued by the Central Savings Bank. He also testified that he received dividend payments from Malakoff on his $2,000 investment in the form of three or four checks which commenced one month from the time that he gave the $2,000 to Malakoff. The last dividend payment received by Karapontso was in the form of cash because Malakoff told him that there was

some kind of a tie-up and that he could not send a check out but would give him cash.

[fol. 146] The Siegel, Berg report shows that a check for $33.34 was given to Karapontso from the Nazareth account in the Second National Bank on March 2, 1953. This represents 1/12th of annual interest at the rate of 20% per annum on $2,000. The $2,000 was claimed to have been given to Malakoff on November 10, 1952. Claimant should have received an adjusted dividend on December 1, 1952 and dividends of $33.34 in January and February 1953 and April 1953. In addition, claimant must have received a cash dividend from Malakoff for May 1953 when Malakoff was having difficulty in making dividend payments. Therefore it seems fair to say that claimant received a total of $188.92 in so-called dividends but actually representing a return of capital.

Claimant's testimony that $1,000 in cash was advanced was not supported by any written documents but this claimant seems to have been a truthful witness and his testimony in this respect should be accepted. He gave Malakoff $2,000 for an investment in Nazareth and Malakoff acknowledged receipt thereof by the endorsement of the stock certificate. The dividends also support an investment of $2,000. Since the sum of $188.92 was returned the balance of $1,811.08 represents the net fair value of the investment of Lazar Karapontso in Nazareth.

57. Claim No. 40 for 9 shares was filed by *Ernest Pollak* based upon Certificate No. 31 dated the 2nd day of February 1953. There is no power of attorney attached to this claim although the name of Richard S. Hull, Esq. appears on the cover of the proof of stock claim. The stated consideration for the issuance of the stock is as follows: a [fol. 147] check for $7,000 to John Malakoff dated December 15, 1952, a check for $500 to John Malakoff dated December 11, 1952 and $1500 in cash paid to Malakoff on or about December 16, 1952.

Objections to the allowance of Stock Claim No. 40 of Ernest Pollak were filed by the debtor on the same grounds as to the objections to the stock claim of Gussie Schwartz. The Margolis group also filed objections to the allowance of

the stock claim, on the same grounds as it objected to the stock claim of Lazar Karapontso except that the Margolis group charged that there was no proof of payment to Malakoff of $1500 in cash. Notice of a hearing on the objections was given by the Examiner to Pollak, Joseph Tiefenbrun, Esq., who had filed an answer on behalf of Pollak to the Margolis objections, to Melvin L. Robbins, Esq., attorney for Robert H. Davidson, Assignee, and to the attorney for the debtor and the attorney for the Margolis group.

Pollak first met Malakoff around December 1952. He was introduced to Malakoff by Anne Rosen in Malakoff's office in New York. Pollak purchased stock from Malakoff giving him $7500 in two checks, one for $500 and the other for $7,000 and approximately one week later Pollak gave Malakoff the remainder in cash. Pollak produced two checks, one for $500 dated December 11, 1952 payable to John Malakoff, Agent, and the other dated December 15, 1952 for $7,000 payable to John Malakoff. The first check was endorsed John Malakoff, Agent and the second John Malakoff and John Malakoff, Agent. Both checks were deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company.

[fol. 148] Pollak did not get a receipt from Malakoff but did receive a stock certificate on or about February 2, 1953 at Malakoff's office. Stock Certificate No. 31 is regular on its face, as is the stub for that certificate. There is nothing either on the stub or on the certificate to indicate that the stock was issued subject to any conditions or qualifications.

After the Nazareth transaction, Pollak was involved in other transactions with Malakoff. The Nazareth transaction was his first with Malakoff. On December 29, 1952, Pollak claims to have given Malakoff $4,400 with respect to a proposition in Fairlawn, New Jersey. Pollak testified that he was to get a return of 25% per annum on his Fairlawn investment but that he did not ever receive the return of his $4,400 nor any money in regard to that investment. His next transaction with Malakoff involved a deal in Scranton in which he gave Malakoff $300. This money was never returned to him.

On the same day as the Scranton deal in March 1953, Pollak claims he gave Malakoff $375 on a proposition in

Waverly Place, New York, and on March 26 gave Malakoff an additional $250 on this proposition. This money was never returned to Pollak. Pollak also testified that on May 17, 1953 he lent Malakoff $5,000 which was never returned to him. Pollak produced a check for $5,000 of John Malakoff, Agent dated May 17, 1953 but this was returned unpaid for insufficient funds.

[fol. 149] In connection with Nazareth, Pollak says he received about two checks each in the sum of $150. There were put in evidence two checks of John Malakoff payable to Ernest Pollak each for $150, one dated May 1, 1953 and the other April 1, 1953. These checks undoubtedly represented so-called dividend payments on an investment by Pollak in Nazareth. Each check is 1/12th of annual interest at the rate of 20% per annum on $9,000. The Siegel, Berg report shows that a check for $150 dated February 2, 1953 was given to Ernest Pollak and that a check for the same amount was given to him on March 2, 1953. These checks were made by Nazareth and drawn upon the Second National Bank of Nazareth, Pennsylvania. Thus Pollak received a total of $600 in so-called dividends and not just two checks for $150 each as testified to by Pollak.

Pollak further testified that Malakoff gave him a check for $750 on March 19, 1953 to repay the amount invested by him on the Scranton contract and that Pollak never deposited this check and never received the amount thereof from Malakoff. This check was received in evidence and it shows that it was never presented for payment. Pollak also testified that he mailed a check for $300 to Malakoff on July 1, 1954 and this sum was never returned to him. This mailing was subsequent to the date of the filing of the reorganization petition. According to a paper which purported to be a copy of the covering letter which was sent by Pollak to Malakoff, if the $300 was for Malakoff's personal needs he was to forget about profits and if it was for business then Pollak wished him much luck.

[fol. 150] Pollak assigned his stock to Robert H. Davidson in October 1957 but that assignment is irrelevant to the inquiry into the validity of the stock certificate.

There is only one serious question in issue in connection with Pollak's investment in Nazareth and that is whether

he actually gave Malakoff $1500 in cash in addition to $7500 in checks. The debtor states that the question of fact to be determined is whether Pollak actually gave $1500 in cash. Supporting Pollak's testimony in this regard is the fact that Malakoff, commencing on February 1, 1953 and for three months thereafter, each month paid Pollak dividends based upon a $9,000 investment. It is, of course, possible but most unlikely that in this case Malakoff would have paid dividends based on $9,000 when he had only received $7,500 from Pollak. The record clearly indicates that Malakoff owed Pollak money in connnection with other deals and it seems likely that Malakoff satisfied a personal indebtedness of $1500 to Pollak by applying it to the purchase of Nazareth stock. The fact that Certificate No. 31 was issued for 9 shares when Malakoff was selling shares at $1,000 per share also tends to support an investment of $9,000 by Pollak in Nazareth, despite the fact that in some cases Malakoff issued stock based upon a lesser amount per share. On all the evidence it may fairly be said that Pollak paid $9,000 in consideration for the issuance to him of Stock Certificate No. 31. It might also be added that there is nothing on the certificate or on the stub thereof which indicates that the stock was issued subject to any conditions, qualifications or limitations.

[fol. 151] The sum invested in Nazareth by Pollak is $9,000. The amount returned to him in so-called dividends is $600. Accordingly, the sum of $8,400 constitutes the net fair value of Ernest Pollak's investment in Nazareth.

58. Claim No. 42 for 8 shares of Nazareth stock was filed by *H. Lawrence Laupheimer* based on Certificate No. 23 dated the 2nd day of February 1953. The stated consideration for the said stock is as follows. Check for $4,500 dated October 18, 1951 and $500.00 in cash and $3,000 by transfer to Malakoff of an interest to that extent of claim in the Locust Street Properties in Philadelphia. Power of attorney was executed in blank.

Objections to the allowance of Laupheimer's Stock Claim No. 42 were filed by the debtor and by the Margolis group. The debtor's objections charge that Malakoff did not own stock issued to claimant and that no consideration passed to the debtor. The debtor also in the alternative asked for

an affirmative judgment for $8,000, the unpaid subscription price. The objections of the Malakoff group attempted to incorporate as objections to Laupheimer's claim objections the debtor had filed to the allowance of the stock claims of the Margolis group. In addition, the Margolis objections charged that claimant was not entitled to a credit of $3,000 on the Locust Street Properties; that only $4,500 was paid by claimant for 8 shares of stock and that the 8 shares of stock represented stock in excess of authorized common stock. Notice of a hearing on the said objections was given by Examiner to claimant, to Rose Laupheimer and to the attorney for the debtor and to the attorney for the Margolis group.

[fol. 152] Claimant testified that his first business with Malakoff was for a one-eighth interest in the Locust Street Properties for which he gave Malakoff a check for $2,750 on February 6, 1951. After this investment, Laupheimer claims that he had various discussions with Malakoff about investments and that Malakoff mentioned the Nazareth market as a prime investment. These discussions were held in the home of Malakoff's daughter, Mrs. Harold Plevin. Malakoff showed Laupheimer pictures of the market and told him that it was paying 20% per annum interest and that he hoped it would eventually pay 25%.

According to claimant, as a result of his conversations with Malakoff, he bought five shares in Nazareth for his mother, Rose Laupheimer, at $1,000 per share. Claimant gave Malakoff a check for $4,500 dated October 18, 1951. This check was endorsed John Malakoff, John Malakoff, Agent and was deposited in a Malakoff Agent account in the Corn Exchange Bank Trust Company. Laupheimer received a receipt from Malakoff for the $5,000 dated September 18, 1951. This receipt not only referred to an investment of $5,000 but to 5 shares and to 1/40th of the deal.

Malakoff told Laupheimer that he was the sole agent of the market and could transact all of the business for the market and, so Laupheimer said, impressed Laupheimer with the fact that Malakoff himself was managing the market. On October 18, 1951, Laupheimer also gave Malakoff $500 in cash, and this was done pursuant to Malakoff's request.

[fol. 153] When the check and cash were given to Malakoff, Malakoff said that he hoped to get the stock certificate out very shortly. Laupheimer did not get a separate receipt for the $500 in cash.

In the Fall of 1952, Malakoff again mentioned the Nazareth market to Laupheimer. He suggested that Laupheimer should obtain more shares for his mother because they were a prime investment and had tremendous growth factors. Laupheimer stated that he did not have any money for additional investment in Nazareth and Malakoff said that he might be able to sell the Locust Street Properties. Malakoff offered to give Laupheimer three shares of stock in Nazareth in exchange for Laupheimer's interest of $2750 in the Locust Street Properties and Laupheimer agreed to that transaction. The parties shook hands on the deal.

Laupheimer produced a report of Plavin & Lippel, accountants, on the Locust Street Properties dated January 31, 1953 and addressed to M. S. Sternberg, Esq. This report indicates that Locust Properties Inc. was liquidated on August 18, 1952 and that the stockholders relinquished their stock in exchange for the assets of the corporation, subject to the liabilities thereof. This report shows that the operation of 1415 Locust Street, Philadelphia, Pennsylvania, was continued in the form of a partnership known as Locust Properties, in care of M. Sternberg, 370 Lexington Avenue, New York, New York, until October 23, 1952 when the property was sold. The report also states that M. Laupheimer had an interest of 12½% in the venture. In addition, claimant produced copy of a letter dated Febru-
[fol. 154] ary 5, 1951, addressed to Malakoff and enclosing check for $2,750 to cover the cost of a one-eighth interest in the Locust Street venture, which interest was to be in the name of Mayme H. Laupheimer.

There is nothing in the report dated January 31, 1953 to indicate that the one-eighth interest of M. Laupheimer in the Locust Street venture had theretofore been transferred to Malakoff in exchange for Nazareth stock or otherwise. However, attached to Stock Claim No. 42 is photostatic copy of an alleged letter dated December 12, 1952 from claimant to Malakoff stating that when Malakoff got check for $3000 from the sale of "our interest" in the Locust

Street venture, Malakoff should invest this money for claimant's mother in Nazareth. This letter also recited that Malakoff had theretofore received $500 in cash and claimant's personal check for $4,500. The forthcoming check for $3,000 plus the moneys previously given to Malakoff, so the letter stated, entitled claimant's mother to 8 shares in Nazareth. Neither the original nor the carbon copy of the letter of December 12, 1952 was produced by claimant. Also attached to Stock Claim No. 42 is photostatic copy of a letter dated February 3, 1953 from M. S. Sternberg, Esq. to Mayme H. Laupheimer. This letter stated that Mayme Laupheimer had received a distribution of $3,000 on account of her share of the proceeds of the sale of the Locust Street Properties. Also produced was a photostatic copy of a check of the Commonwealth Title Company of Philadelphia for $19,055.50 payable to Mayme H. Laupheimer and others and representing the proceeds of 1415 Locust Street, Philadelphia. This check bears the endorse-
[fol. 155] ment of Mayme Laupheimer as well as of the other payees and the endorsement of John Malakoff, Special. Thus it seems clear that Malakoff received the $2,750 which claimant had invested in the Locust Street Properties in the name of Mayme Laupheimer. Laupheimer testified that his wife did not endorse this check but that seems to be unimportant since he said that he had agreed to invest the $2,750 from the Locust Street Properties in Nazareth.

Claimant testified that he received income on the moneys he advanced to Malakoff. He received dividends or interest on the Locust Street venture and he received 20% on his investment in the Nazareth market until the time that later checks were returned unpaid.

Rose Laupheimer received a check for $27.77 of John Malakoff, Agent on November 1, 1951. There is nothing on this check to indicate that it was related to the Nazareth venture, although that is the testimony of Laupheimer. This check undoubtedly represented a dividend return on $5,000 for about one-third of a month on the basis of 20% per annum. Between December 1951 and September 1952 each month Rose Laupheimer received a check for $83.33 of John Malakoff, Agent or John Malakoff, Special. Each

check represented one-twelfth annual interest at 20% per annum on $5,000 and corroborates claimant's testimony that during that period he had an investment of $5,000 in Nazareth with Malakoff. In October, November and December 1952 and January 1953 each month a check of John Malakoff, Special for $133.34 was issued to R. Laupheimer. These checks as were the earlier checks, were drawn upon the Corn Exchange Bank Trust Company. Each check is [fol. 156] 1/12th of annual interest at the rate of 20% per annum on $8,000. A check for $133.34 was issued to R. Laupheimer on February 2, 1953 and a check for the same amount was issued to her on March 2, 1953 by Nazareth. These checks were drawn upon the Nazareth account in the Second National Bank of Nazareth, Pennsylvania. A check for $133.34 dated April 1, 1953 and payable to R. Laupheimer signed by John Malakoff and drawn upon the Manufacturers Trust Company was undoubtedly received by claimant. Claimant produced a check dated May 1, 1953 for $133.34 payable to R. Laupheimer which claimant testified was returned unpaid. Therefore the total in dividends received by claimant (or Rose Laupheimer) was $1,794.45.

According to Laupheimer, some time in March 1952 Malakoff called him to his office and discussed with him a project in Houston, Texas. As a result of this conversation and on March 26, 1952, Laupheimer gave Malakoff two checks, one for $1,000 drawn on the Manufacturers Trust Company, New York, and the other for $2,000 drawn on the Sedalia Bank and Trust Company, Sedalia, Missouri. Both checks were endorsed John Malakoff, John Malakoff, Agent, and were deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Malakoff gave Laupheimer a promissory note for $3,000 payable on demand, which was never paid.

Thereafter, Malakoff went to Texas and on his return told Laupheimer that the Houston, Texas, proposition had not panned out and that he would invest Laupheimer's $3,000 in another project. Laupheimer requested Malakoff to give him three shares in Nazareth for his money but [fol. 157] Malakoff told him that no more Nazareth shares were available. He did say that as soon as the shares became available he would buy them for Laupheimer and that

in the meantime he would invest Laupheimer's money in the Hotel Margaret in Brooklyn, New York. Laupheimer evidently acquiesced in the investment of the $3,000 in the Hotel Margaret. He did not receive from Malakoff any receipt other than the note heretofore mentioned nor did he get any form of memorandum reflecting the purported investment in the Hotel Margaret. Laupheimer did get from Malakoff a series of $50 checks which ran from May 1952 through April 1953 and which purported to represent dividends at the rate of 20% per annum on an investment of $3,000 in the Hotel Margaret.

Laupheimer testified that Malakoff did not tell him that he was selling his own stock in Nazareth to Laupheimer. He claims that Malakoff told him that he owned none of the properties which he managed but acted only as agent for the properties. He did not recall ever having received any checks drawn by the Nazareth market but it is clear that he did receive Nazareth checks for the February and March 1953 dividends on his $8,000 investment. Laupheimer admitted that Malakoff did not tell him that a corporation owned the market and he did not remember whether the word corporation was mentioned at all. Malakoff made reference to stock although not necessarily in connection with a particular corporation by saying that there was 200 shares of stock issued for the Farmers Market and that Laupheimer was buying five shares. Malakoff did tell Laupheimer that he controlled the corporation.

[fol. 158] Stock Certificate No. 23 is regular on its face. The stub for that certificate, however, contains the following legend: "Transfer to *Ambass* out". This legend would seem to indicate that Laupheimer's investment in Nazareth was transferred to Ambassador Estates and that the stock should therefore be excluded. Nevertheless, there is no clear evidence in the record which would support the inference that Laupheimer's investment in Nazareth was transferred to Ambassador Estates and he is entitled to have any doubts resolved in his favor. It may be noted that Mayme Laupheimer, whose name has been mentioned above, is the wife of H. Lawrence Laupheimer. The fact that Malakoff paid dividends to R. Laupheimer, the mother of claimant through April 1953 on $8,000 indicates that at

least as late as April 1953 Malakoff regarded the $8,000 as still invested in Nazareth.

Malakoff considered that Laupheimer had invested $8,000 with him in the Nazareth venture. Malakoff paid so-called dividends based on such an investment. Claimant does not contend that he invested more than $7,750 in Nazareth. It appears that Malakoff was willing to pay dividends on the additional $250 in order to be permitted to retain $2,750 invested by Laupheimer in Locust Street Properties. Therefore the actual investment by Laupheimer was $7,750 against which he received a total of $1,794.45 in so-called dividends. Accordingly, the sum of $5,955.55 constitutes the net fair value of the investment made by H. Lawrence Laupheimer in Nazareth.

[fol. 159] 59. Claim No. 11 for 7 shares of Nazareth stock was filed by *Arnold A. Weinstein*. This claim is based on Certificate No. 18 dated the 2nd day of February 1953. The stated consideration for the said stock is check for $7,000 dated September 19, 1951 payable to the order of John Malakoff. Claimant also asserts an alternative claim for $7,000 as a general creditor on the following theory:

"That John Malakoff, the then President of the Debtor, and as such, fraudulently represented to Claimant on or about the 12th day of September 1951, that he was the President of the Debtor Corporation, that the said Corporation was authorized to issue Two hundred (200) shares of stock, that said stock was duly issued to him and that 7 of such shares were being sold to Claimant for $7,000.00. On the basis of the foregoing representations, deponent issued his check to John Malakoff as above stated on or about the 19th day of September 1951 which check was earmarked on the reverse side thereof for Nazareth Farmers Market (see attached photostat). In the event that the Court finds that Claimant is not a legal stockholder of the Debtor for 7 shares of its capital stock then, and in that event, and in the alternative, Claimant's claim is asserted as that of a general creditor against the Debtor for damages in the sum of $7,000.00 as a result of the fraudulent misrepresentations made by John Malakoff, as President of the Debtor Corporation, in reliance upon which Claimant

paid the sum of $7,000.00 for the purchase of the aforesaid stock. The Debtor by its conduct, having allowed and permitted its President, John Malakoff, to conduct the affairs of the Corporation, including this transaction, in such manner that it is and should be estopped from denying re-
[fol. 160] sponsibility or the authority of John Malakoff, its then President."

No attorney in fact was designated in the proof of stock claim.

Objections to the allowance of Weinstein's Stock Claim No. 11 were filed by the debtor by H. Lawrence Laupheimer, Secretary, and were subscribed by Alex L. Rosen, attorney for the debtor. These objections were sworn to on the 5th day of November 1957. The objections charge that Malakoff did not own the stock certificates which were delivered to claimant and that no consideration passed to the debtor. The debtor set up a counterclaim for $7,000, the unpaid subscription price. Objections to the allowance of Stock Claim No. 11 were also filed by the Margolis group. One objection attempted to incorporate as an objection to the Weinstein stock claim objections filed by the debtor to the allowance of the stock claims of the Margolis group. In another objection, it was charged that the seven shares of stock sold to Weinstein were part of an excess over the authorized 200 shares of capital stock. In a third objection, it was alleged that in September 1951, Weinstein acted as attorney for Malakoff that as such attorney he prepared a letter in behalf of Malakoff, which was sent to the investors informing them in effect that Malakoff (a) had acquired all the stock of the debtor, (b) would decide whether Nazareth would be operated as a corporation, a joint venture or a limited partnership, (c) would determine as to the sale of the debtor's business and the terms thereof, (d) had declared dividends at the rate of 20% annually, [fol. 161] and (e) had acknowledged the amount of money paid by the investor and the number of shares that would be issued, etc. It was further alleged that dividends at the rate of 20% per annum were paid monthly beginning in September 1951 with the last payment in May 1953 or thereabouts; that Weinstein had received nineteen pay-

ments aggregating $2,216.54; that one Helen Bernstein had been instrumental in causing Weinstein to invest in Nazareth; that Weinstein on one or two occasions had acted as attorney for Helen Bernstein; that Helen Bernstein had been instrumental in selling a total of 66 shares of Nazareth stock for Malakoff; that Helen Bernstein received $400 for each share sold or a total of $26,000; that she had received $2,800 for inducing Weinstein to invest $7,000 with Malakoff for an interest in Nazareth; that Weinstein on behalf of the debtor in objections filed to the claims of various stockholders had urged that Malakoff had no right to issue stock or, in effect, had no authority to accept money for the sale of stock in Nazareth; and that if the debtor's objections to the claims of other stockholders were upheld and Weinstein's claim as a general creditor for $7,000 was allowed, there should be a set-off and counterclaim in favor of the debtor of $5,016.54 representing the sum of $2,216.54 paid by Malakoff to Weinstein as dividends and $2,800 paid to Helen Bernstein as commissions.

Objections to the allowance of the Weinstein stock claim were also made by the Margolis group on other grounds. Stock claimant Weinstein filed a reply to the counterclaims of the debtor and the Margolis group on or about the 12th day of May 1958. Notice of a hearing on the said objections was given to the stock claimant and to the attorney for the debtor and to the attorney for the Margolis group by the examiner.

[fol. 162] Claimant testified that he met Malakoff for the first time in the latter part of August or possibly early in September 1951. This meeting with Malakoff resulted from a conversation claimant had with his father-in-law, Bernhard S. Gottlieb, who indicated to him that Malakoff was engaged in a venture which might be remunerative. Weinstein called Malakoff and made an appointment to meet him. On the telephone he talked to Malakoff about an opportunity to view the Nazareth market in Pennsylvania. Weinstein met Malakoff in his car and also met Helen Bernstein, to whom he had been introduced on an earlier occasion. They drove to Nazareth.

Malakoff told Weinstein that the price for an interest in the market was $1,000 per share. He said that he did not know whether he was going to operate the market as a limited partnership or a corporation. Malakoff told Weinstein that he had sold some interest in the market to some people who had asked for receipts, and he asked Weinstein to draft a receipt for him that he could use in connection with his solicitation of investors. Weinstein agreed to this undertaking.

About a week after visiting Nazareth, Weinstein drafted a receipt from Malakoff and sent the original copy of a draft to Malakoff. This draft was dated September 14, 1951 and provided substantially as follows:

(1) acknowledged receipt of a check "In the Matter of Nazareth and Farmers Auction Market at Nazareth, Pennsylvania".

(2) stated the understanding of the parties to be "that all of the authorized stock of the Nazareth Farmers and Auction Market Inc., which owns the market, has been issued to me (Malakoff)".

[fol. 163] (3) stated that Malakoff was obligated to the addressee of the letter for a proportionate share of his earnings, dividends, liquidating or otherwise, and profits from the market as Malakoff received them.

(4) stated that dividends had been declared at the rate of 20% per annum and it was expected that dividends at the same rate would be paid on the first day of each month.

(5) stated that Malakoff might cause to be issued to the addressee a specified number of shares of his "present stockholdings" and that Malakoff might cause the dissolution of the corporation and the formation of a limited partnership in which the addressee would be a limited partner and the specified amount invested would be applied as the addressee's contribution "with a corresponding proportionate interest".

(6) the method of operation was to remain solely in Malakoff's hands.

(7) the sale of the market by Malakoff, entirely within the discretion of Malakoff, if made, was ratified by the addressee, provided a majority in interest of the stockholders approved the sale or the sale was authorized and approved by the general partner or partners.

(8) Malakoff agreed to pay the addressee the specified amount invested should the addressee at any time desire to liquidate the rights evidenced by the letter.

Some few days after sending Malakoff the draft, Weinstein received a telephone call from Malakoff. In that telephone call, Weinstein was asked whether he was prepared to make an investment in the venture and he replied that he was ready to invest $7,000. Weinstein then issued a check to the order of Malakoff for $7,000 and forwarded the same to him.

[fol. 164] Claimant produced a check for $7,000 payable to Malakoff dated September 19, 1951. This check was endorsed John Malakoff, John Malakoff, Agent and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Over the endorsement of Malakoff appears the legend "Re Nazareth Farmers Mkt.". Weinstein testified that the legend was placed on the check by him before the check was forwarded to Malakoff.

According to Weinstein, he did not receive an immediate acknowledgment from Malakoff regarding his investment but on the first of subsequent months he did get checks signed by Malakoff Agent and in some instances Malakoff Special, representing a return on the investment. Commencing with November 1951 and through January 1953, Weinstein each month received a check of John Malakoff, Agent or John Malakoff, Special in the sum of $116.66. These checks represented so-called dividends upon Weinstein's investment of $7,000 in Nazareth at the rate of 20% per annum. Weinstein also received a Nazareth check on the Second National Bank of Nazareth dated February 2, 1953 for $116.66 and a check for the same amount on the same account dated March 2, 1953. In addition, he received a check dated April 1, 1953 of John Malakoff drawn on the Manufacturers Trust Company for $116.66 and an-

other Malakoff check drawn on the same bank for the same amount dated May 1, 1953.

Four or five months after the investment was made by Weinstein, he had a conversation with Malakoff at which time he requested some acknowledgment or receipt concerning the $7,000. Weinstein testified that Malakoff in- [fol. 165] formed him that he would forward a receipt and subsequently Weinstein received a letter receipt from Malakoff dated September 14, 1951. This letter covered the receipt of $7,000 from Weinstein and was substantially in the form of the draft prepared by Weinstein except that it did not give Weinstein the option of liquidating his rights as evidenced by the letter so as to require the return to him of the $7,000 invested by him with Malakoff in the Nazareth venture.

Weinstein testified that he received the letter receipt in January or February 1952. On or about the 2nd or 3rd day of February 1953 Weinstein received Stock Certificate No. 18 for 7 shares. The stock certificate is regular on its face except that it bears the following legend "Subject to letter of agreement with John Malakoff." The stub for Certificate No. 18 is regular on its face and there is nothing thereon to indicate that it was subject to any conditions or qualifications.

Weinstein continued to receive dividends on his investment in Nazareth subsequent to the receipt of the stock certificate. These dividends continued until some trouble with Malakoff arose around May 1953. As a result of this trouble, Malakoff resigned as President of the corporation and Charles Kanter, Benjamin Margolis and Weinstein were elected directors.

Weinstein testified that he had not done any business with Mrs. Bernstein or Malakoff, whether by way of exchanges, loans, advances or transactions of any kind or nature, other than drafting the original letter receipt mentioned above. When he drove to Nazareth with Malakoff, [fol. 166] Weinstein formed the impression that Malakoff was acting as an agent and was promoting the Nazareth deal. This was so despite the fact that the draft prepared by Weinstein stated that all of the authorized stock had been issued to Malakoff. The name of the corporation in-

corporated by Weinstein in the letter receipt was given to him by Malakoff on their trip to Nazareth. Weinstein did not write the name down and incorporated the name in the draft from memory.

Weinstein's impression was that he was buying into a venture and at that time it wasn't understood whether the venture would be an existing corporation, a new corporation or a limited partnership. Weinstein admitted that he never made out a check to Nazareth and that he never paid any consideration directly to Nazareth. Weinstein received $75 for preparing the draft of the letter receipt. Weinstein did not do any work for Malakoff, Nazareth or any other firm connected with Malakoff or Helen Bernstein other than the transaction mentioned above. He emphasized this fact.

It is perfectly plain that Weinstein gave Malakoff $7,000 for the purpose of acquiring Nazareth stock. There is nothing in the record to support the charge that Helen Bernstein received the sum of $2800 for inducing Weinstein to invest $7,000 with Malakoff for an interest in Nazareth. Furthermore, if such a commission was paid to Helen Bernstein by Malakoff, the record is barren of any proof that Weinstein had the slightest knowledge of that fact. Weinstein dealt with Malakoff and presumably was [fol. 167] willing to rely upon Malakoff. He invested $7,000 in Nazareth stock and the sum of $2,216.54 was returned to him by way of so-called dividends. Accordingly, the sum of $4,783.46 constitutes the net fair value of the investment of Arnold Weinstein in Nazareth.

60. Claim No. 41 for 3 shares of Nazareth stock was filed by *Aaron Fried*. This claim is based on Stock Certificate No. 25 dated the 2nd day of February 1953. No consideration is set forth in the proof of claim which therefore fails to satisfy Section 57a of the Bankruptcy Act and Official Form No. 28. Power of attorney runs to Meyer Kraushaar, Esq. 42 Broadway, New York 4, New York.

Objections to the allowance of Stock Claim No. 41 of Aaron Fried were filed by the debtor and by the Margolis group. The debtor's objections were based on lack of title

in Malakoff and no consideration passing to Nazareth, and also contained a counterclaim for $3,000, the unpaid subscription price. The Margolis objections, among other things, pointed up the fact that claimant had failed to prove the payment of $2,000 to Malakoff.

Jerome Fried, the manager of the Nazareth market, acted for his father in the acquisition by his father of three shares of Nazareth stock. Aaron Fried gave his son Jerome a check dated December 7, 1951 to deliver to John Malakoff. Claimant produced photostatic copy of a check dated December 7, 1951 of Aaron Fried for $1,000 payable to John Malakoff. This check was endorsed John Malakoff, John Malakoff, Agt. and was deposited in the Corn Exchange [fol. 168] Bank Trust Company in the Malakoff Agent account. Over the endorsement of John Malakoff appears the legend "1/200 share of Nazareth Farmers Market Pa." The legend is in the handwriting of Jerome Fried. Jerome Fried has no recollection of the time or place when he gave the check to Malakoff. The check itself shows that it was deposited on or about December 10, 1951 and of course it reached Malakoff since it was deposited in his Agent account.

Claimant also produced through Jerome Fried two additional checks of Aaron Fried payable to the order of John Malakoff. One check was dated January 7, 1952 and was for $1,000 and the other was dated October 20, 1952 and was for $2,000. The $1,000 check was payable to John Malakoff and was endorsed John Malakoff, John Malakoff Agt. and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company on or about January 9, 1952. The following legend appears over the endorsements "For 1/200 share of Nazareth Farmers Market." The $2,000 check was payable to John Malakoff Agent and was endorsed John Malakoff Agent and deposited in the same account. Over the endorsement appears the following legend "1000—Loan, 1000—1/200 shares of Nazareth."

Jerome Fried testified that the legend over the endorsement on the $2,000 check was placed thereon by him. Malakoff told Fried that the investment would pay 20% and Fried in turn told this to his father.

A check for $16.67 of John Malakoff Agent was issued to Aaron Fried on January 2, 1952 and was drawn upon the Corn Exchange Bank Trust Company. This check pre-

[fol. 169] sumably represented interest on $1,000 at 20% per annum for December 1951. In February, March, April, May, June, July, August, September, October and November 1952, each month, Aaron Fried received a check for $33.34 of John Malakoff, Special, drawn on the Corn Exchange Bank Trust Company. These checks represented monthly interest on $2,000 at the rate of 20% per annum. In December 1952 and January 1953 claimant received a check for $50 each month of John Malakoff, Special drawn on the Corn Exchange Bank Trust Company. Each check represented interest at the rate of 20% per annum on $3,000. Claimant also received a check for $50 on February 2 and a check for the same amount on March 2, 1953, both checks being drawn by Nazareth upon the Second National Bank of Nazareth, Pennsylvania. In addition, claimant received a check for $50 of John Malakoff dated April 1, 1953 and drawn upon the Manufacturers Trust Company. These so-called dividend checks support the investment totalling $3,000 claimed to have been made by Aaron Fried in Nazareth stock. Besides, claimant received a check of John Malakoff for $83.34 dated May 1, 1953 and drawn upon the Manufacturers Trust Company. This check seems to have represented further dividends upon the Nazareth investment.

A number of checks of John Malakoff Agent drawn to the order of Aaron Fried, claimant herein, were received in evidence. Jerome Fried testified that these checks were part of exchanges or short term loans. He also testified that [fol. 170] occasionally his father would obtain a small profit on an exchange with Malakoff. According to Jerome Fried at no time did his father engage in any real estate deals with Malakoff, except with respect to Nazareth. He could not explain an entry in a check book which referred to an evident participation of Aaron Fried to the extent of $2,000 in certain property known as 69th Road. Jerome Fried was positive that neither he nor his father made any investment with Malakoff in the Hotel Margaret and that he did not get any dividends from the Hotel Margaret.

Stock Certificate No. 25 is regular on its face. The stub for that certificate is regular except that the word "out" appears thereon. There is nothing in the record to indicate

what this word "out" means and any doubts should be resolved in favor of claimant.

It is true, as the debtor contends, that the testimony of Jerome Fried in regard to his father's transactions with Malakoff is contradictory. However, there is no evidence of fraud or diversion of assets of Nazareth which can be imputed to Aaron Fried. There is insufficient proof in the record to establish that Aaron Fried received in return from Malakoff substantially more than he advanced to Malakoff, apart from the Nazareth transaction. Aaron Fried seems to have made an investment of $3,000 in Nazareth. The sum of $683.41 was returned to him by way of so-called dividends. Accordingly, the sum of $2,316.59 constitutes the net fair value of Aaron Fried's investment in Nazareth.

[fol. 171] 61. Claim No. 31 for one share of Nazareth stock was filed by *George Bond.* This claim is based on Certificate No. 48 dated the 2nd day of March 1953. The stated consideration for the said stock is check of Jeanne R. Bond to the order of George H. Bond for $1,000 dated February 27, 1953 and endorsed to the order of John Malakoff. Power of attorney runs to Bernard Buchwald, Esq.

Objections to the allowance of Stock Claim No. 31 of George Bond were filed by the debtor and the Margolis group. The debtor's objections were that Malakoff had no title to the stock issued to claimant and that no consideration passed to Nazareth. The debtor set up a counterclaim for $1,000, the unpaid subscription price. The Margolis objections were based largely upon the fact that the certificate issued to claimant represented stock in excess of the authorized issue of 200 shares. Notice of a hearing on the said objections was given by the Examiner to claimant, the attorney for the debtor and the attorney for the Margolis group. No notice was given to Bernard Buchwald, Esq. but the claimant appeared in person at the hearing on objections and offered no objection to the lack of notice to his designated attorney in fact.

Claimant testified that he learned of Nazareth through some of his friends among whom was Harold Masur. Masur was the intermediary for Bond's acquisition of the stock

and Bond gave the check for the stock to Masur. Claimant produced photostatic copy of check of Jeanne R. Bond for $1,000 payable to George H. Bond dated February 27, 1953 [fol. 172] and drawn upon the Chase National Bank. This check was endorsed as follows: "one—pay to the order of John Malakoff one share of Nazareth Farmers Market George H. Bond, John Malakoff ok for *cash* M S Sternberg."

Jeanne R. Bond is George Bond's sister. After the check was given to Malakoff claimant received Stock Certificate No. 48 for one share of Nazareth stock. This certificate is regular on its face but has the following typewritten endorsement: "This stock pays twenty per cent per annum, payable in equal monthly payments on the first day of each month." The stub for Certificate No. 48 is also regular on its face and contains no qualifications or conditions whatsoever.

Claimant received from Malakoff a check for $16.67 dated April 1, 1953 drawn upon the Manufacturers Trust Company and a check for the same amount dated May 1, 1953 drawn upon the same bank. Each check represented so-called monthly dividends on $1,000 invested in Nazareth at the rate of 20% per annum.

Claimant had another transaction with Malakoff involving the purchase of stock in the Hotel Margaret. This investment must have been made early in 1952 since claimant received dividend checks from Malakoff on that investment during the major portion of 1952 and the early part of 1953.

George Bond invested $1,000 in Nazareth through Malakoff. The sum of $33.34 was returned to him. Accordingly, the sum of $966.66 constitutes the net fair value of George Bond's investment in Nazareth.

[fol. 173] 62. Claim No. 32 for 3 shares of Nazareth stock was filed by *Tess J. Schwartz*. This claim is based upon Certificate No. 60 dated the 20th day of March 1953. The stated consideration for this stock is a check for $3,000 dated March 17, 1953 endorsed over to Malakoff. Power of attorney runs to Bernard Buchwald, Esq.

Objections to the allowance of the stock claim No. 32 of Tess Schwartz were filed by the debtor and the Margolis

group. The debtor's objections are similar to those urged against the allowance of the claim of George Bond. The objections of the Margolis group were also substantially the same as those advanced to the allowance of the Bond stock claim. Claimant filed a paper characterized as "Answer of Tess J. Schwartz to objections to creditors claim." Notice of a hearing on the said objections was given to claimant, the attorney for the debtor and the attorney for the Margolis group. No notice was given to Bernard Buchwald, Esq. Claimant appeared at the hearing on her stock claim and offered no objection to the lack of notice to her designated attorney in fact.

Claimant testified that she bought three shares of Nazareth stock in March 1953. She said her brother and her mother both had stock and she decided that she would have some too. She was living in Florida at the time and sent a check to her brother, Harold Schwartz, with the request that he purchase three shares for her. She talked to no one about the stock purchased other than members of her family.

[fol. 174] Claimant produced check for $3,000 made by Tess J. Schwartz to the order of H. B. Schwartz dated March 17, 1953 and drawn upon the Florida National Bank and Trust Company at Miami, Florida. This check bears the following endorsements: "For 3 shares of Farmers Market Harold B. Schwartz, H. B. Schwartz, John Malakoff, Benjamin Margolis."

Claimant also produced a letter from Malakoff to Harold B. Schwartz acknowledging receipt of check for $3,000 for 3 shares of Nazareth stock for his sister, Tess J. Schwartz. Stock Certificate No. 60 was also enclosed in that letter. This certificate is regular on its face but has the following endorsement: "This certificate represents three $1,000. shares ($3,000.). It is guaranteed to pay a minimum return of twenty (20%) per cent per annum in equal monthly payments on the first day of each month. John Malakoff." The stub for Certificate No. 60 is also regular on its face and has no qualifications or conditions whatsoever.

Claimant received one so-called dividend check for $50. Claimant testified that she received only this one so-called dividend check from Malakoff, which was returned. She

produced a check dated June 4, 1953 of John Malakoff for $50 payable to her order and drawn upon the Industrial Bank of Commerce of New York. This check was returned for insufficient funds. The amount of this check represents the June dividend on a $3,000 investment at the rate of 20% per annum. Since claimant gave Malakoff $3,000 in March, she should have received a $50 dividend check on or about May 1. However, there is no evidence to sup-
[fol. 175] port a finding that she actually received $50 in May so her testimony that she received only one dividend check which was returned cannot be refuted.

Concededly claimant gave Malakoff $3,000 for an investment in Nazareth. She did not know Malakoff nor did she ever meet him. No part of the $3,000 was returned to claimant. Therefore the sum of $3,000 constitutes the net fair value of claimant's investment in Nazareth.

63. Claim No. 24 for 2 shares of Nazareth stock was filed by *Cydney Grosman*. This claim is based upon Certificate No. 61 dated the 25th day of March 1953. The stated consideration for this stock is claimant's check for $2,000 to Malakoff dated March 25, 1953. Power of attorney runs to Bernard Buchwald, Esq.

The debtor and the Margolis group both filed objections to the allowance of Stock Claim No. 24 substantially upon the same grounds as the objections filed to the allowance of the claim of George Bond. Notice of a hearing on the objections was given by the Examiner to claimant, the attorney for the debtor and the attorney for the Margolis group. No notice was given to Bernard Buchwald, Esq. but claimant appeared at the hearing and did not object to such lack of notice.

Claimant was introduced to Malakoff by Helen Bernstein and Harold Masur on March 25, 1953. Claimant talked to Malakoff about the purchase of Nazareth stock and gave Malakoff a check for $2,000 dated March 25, 1953 drawn upon the Manufacturers Trust Company. The check [fol. 176] bears the following endorsement: "2 shares of Nazareth Farmers Market John Malakoff, John Malakoff, Special." This check was deposited in the Malakoff Special account in the Corn Exchange Bank Trust Company. In

return for the check, claimant received Stock Certificate No. 61.

Stock Certificate No. 61 is regular on its face but has the following endorsement: "This certificate represents two $1,000. shares ($2,000.). It is guaranteed to pay a minimum dividend of twenty (20%) per cent per annum in equal monthly payments on the first day of each and every month. John Malakoff." There is nothing on the stub for Stock Certificate No. 61 to indicate that it was issued subject to any conditions or qualifications.

Claimant did not receive any memorandum from Malakoff at the time he received Stock Certificate No. 61. Claimant knew Helen Bernstein prior to March 1953 but did not know Malakoff. Helen Bernstein told him that Nazareth was a good investment and that he would get 20% a year on his money. Claimant did not have any previous dealings of any kind with Malakoff.

Subsequent to March 25, 1953 claimant did not have any transactions with Malakoff aside from the income he received in connection with Nazareth. He received a dividend check for $5.55 in April 1953, a dividend check for $33.33 in May 1953 and a dividend check for $33.34 in June 1953. He therefore received a total of $72.22.

[fol. 177] Claimant paid no money directly to Nazareth. Nevertheless claimant in good faith gave Malakoff $2,000 for investment in Nazareth. The sum of $72.22 was returned to him. Accordingly, the sum of $1,927.78 constitutes the net fair value of Cydney Grosman's investment in Nazareth.

64. Claim No. 37 for one share of Nazareth stock was filed by *Rose Kaplan*. This claim is based upon Stock Certificate No. 40 dated the 2nd day of February 1953. The stated consideration for this stock is $1,000. No attorney in fact is designated in the claim.

The debtor filed objections to the allowance of Stock Claim No. 37 of Rose Kaplan. These objections were based upon no title in Malakoff and no consideration to the corporation and included a counterclaim for $1,000, the unpaid subscription price. Notice of a hearing on said objection was given by the Examiner to the claimant and the attorney for the debtor.

Claimant met Malakoff at the home of Gertrude Klein. This was prior to February 17, 1953. Malakoff suggested to claimant's husband that he buy Nazareth stock.

Thereafter, Rose Kaplan mailed her check for $1,000 to John Malakoff. This check was drawn upon the County Trust Company of Mount Vernon, New York, was dated February 17, 1953 and was endorsed "For deposit John Malakoff, John Malakoff, Special." The check was deposited in a Malakoff Special account in the Bank of the Manhattan Company.

[fol. 178] After the check was mailed to Malakoff, claimant received through the mails Certificate No. 40. This certificate is regular on its face. The stub for Stock Certificate No. 40 is also regular on its face except that the word "out" appears thereon. No testimony was adduced to explain the presence of this word on the stub.

Approximately one week after February 17, 1953, claimant received a dividend check for Sixteen dollars and some cents. This must have been $16.67. Claimant stated that she did not receive any further dividend payments and there is no evidence to the contrary. Claimant had no other transactions with Malakoff apart from her Nazareth investment.

Claimant paid no money directly to Nazareth. Nevertheless, claimant in good faith gave Malakoff $1,000 as an investment in Nazareth stock. The sum of $16.67 was returned to her. Accordingly, the sum of $983.33 constitutes the net fair value of Rose Kaplan's investment in Nazareth.

65. Claim No. 26 for 5 shares of Nazareth stock was filed by *Robert A. Noire*. This claim is based upon Certificate No. 58 dated the 2nd day of March 1953. The stated consideration for this stock is $5,000 in the form of a check for that amount endorsed over to Malakoff. No attorney in fact was designated in the claim.

Objections to the allowance of Stock Claim No. 26 were filed by the debtor and the Margolis group. These objections were substantially the same as those advanced to the allowance of the stock claim of George Bond. Claimant filed an answer to the Margolis objections. Notice of a hearing on the said objections was given by the Examiner to claimant and other parties in interest.

[fol. 179] Claimant testified that he heard of Nazareth stock from Helen Bernstein during the winter of 1952-53. Helen Bernstein was a customer in the beauty salon in which Noir was a hair stylist. After talking with Helen Bernstein, Noir and his wife decided to obtain some Nazareth stock.

Claimant met Malakoff on March 16, 1953. He was introduced to Malakoff by Helen Bernstein. According to Noire, Malakoff told Noire and his wife that he, Malakoff, was the President of the Nazareth corporation. He explained the Nazareth corporation and showed Noire a stock certificate and then said that each share would cost $1,000. Noire asked Malakoff if he would personally guaranty the investment and Malakoff told him that he would.

At the meeting on March 16, 1953 Noire gave Malakoff a check for $5,000 of the Greenwich Savings Bank payable to Robert A. Noire which Noire endorsed in blank. Underneath Noire's endorsement is the endorsement of John Malakoff and the following: "ok for cash M.S. Sternberg". Noige must have been prepared to invest $5,000 in Nazareth because he came to Malakoff's office with the savings bank check.

Evidently on the 16th day of March 1953, Noire received from Malakoff in exchange for his check Stock Certificate No. 58. This stock certificate had previously been signed in blank by Jerome Fried as Secretary and had been dated the 2nd day of March 1953. It is not clear whether Malakoff signed the certificate on March 16 or prior thereto but that is unimportant. The stock certificate has the following [fol. 180] endorsement "This stock certificate represents five (5) $1,000. shares. It is guaranteed to pay a minimum return of twenty (20%) per-cent per annum in equal monthly payments. The original investment of $5,000. is also personally guaranteed by JOHN MALAKOFF. John Malakoff." The stub for Certificate No. 58 is completely regular on its face. Claimant received no dividends from Malakoff.

Noire did not have any dealings of any kind with Malakoff other than his Nazareth deal. He also had no dealings with Helen Bernstein apart from her patronizing his place of business. Noire understood that he was buying stock of a corporation, original issue, direct from the corpora-

tion but that is not consistent with Noire's turning over the bank check to Malakoff personally. In any event, Noire gave Malakoff $5,000 for investment in Nazareth. He did so in good faith. No part of the $5,000 was returned to him. Accordingly, the sum of $5,000 constitutes the net fair value of the investment of Robert A. Noire in Nazareth.

66. Claim No. 6 for 10 shares of Nazareth stock was filed by *Harry Forman*. This claim is based upon Certificate No. 59 for 5 shares dated the 13th day of March 1953 and Certificate No. 73 for 5 shares dated the 23rd day of April 1953. The stated consideration for this stock is $11,000. No attorney-in fact is designated in the proof of claim.

Objections to the allowance of Stock Claim No. 6 of Harry Forman were filed by the debtor and by the Margolis group. The debtor's objections alleged that Malakoff did not own the stock represented by the certificates which were delivered to claimant; that the stock was delivered [fol. 181] for balances due claimant for personal indebtedness purportedly owed by Malakoff to claimant; that no consideration passed to the debtor; that whatever balances were due by Malakoff to claimant were based upon New York transactions involving a usurious rate of interest; that one certificate issued to claimant did not have duly authorized signatures; that Malakoff owed no money to claimant at the time the stock was issued to him; and that the stock held by claimant is in the overissued stock of Nazareth. The Margolis objections also pleaded overissue and other objections.

Claimant filed an answer to the objections of the debtor. Notice of the hearing on the said objections was given by the Examiner to claimant and other parties in interest.

Claimant testified that he first met Malakoff some time around 1936. Prior to 1950, claimant was an insurance agent and real estate broker and came to know Malakoff because he worked for the renting agent of the building where Forman had his office. Malakoff referred some insurance business to Forman and they became friendly. Malakoff did not receive any commissions from Forman on the business that he referred to him.

In 1950 or 1951, Forman was asked by Malakoff to enter into a joint venture with him. Forman had made some loans to Malakoff to repay Malakoff for his past consideration and these loans had evidently been repaid.

Some time in March 1953, Malakoff went to Forman's office which was at Astor Place and Fourth Avenue. No one else was present. Malakoff asked Forman whether he [fol. 182] would be interested in purchasing some stock in Nazareth. He described the operation of the market in very glowing terms and recommended that Forman purchase five shares of stock. Forman agreed to buy five shares of stock for $5,000. At that time there were no open transactions between Forman and Malakoff and neither one owed the other any money.

Forman claimed that he paid for the five shares with a check for $5,000 of Alwin Curtain Shop payable to John Malakoff. He said that he returned this $5,000 to the Alwin Curtain Shop thereafter. He also testified that there was no other consideration paid by him to Malakoff for the purchase of the five shares of stock represented by Certificate No. 59, which he claimed he got from Malakoff in his (Forman's) office in March 1953.

Forman then produced check of Alwin Curtain Shop for $5,000 dated April 23, 1953 payable to the order of John Malakoff and drawn upon the Public National Bank and Trust Company. This check was endorsed John Malakoff and was deposited in the Corn Exchange Bank Trust Company. He also produced his check for $5,000 dated July 15, 1953 drawn on the Corn Exchange Bank Trust Company and payable to Alwin Curtain Shop. When it was pointed out that he had testified that Stock Certificate No. 59 had been given to him in March 1953 by Malakoff whereas the Alwin Curtain Shop check was dated April 23, 1953 he stated that he had inadvertently presented the wrong certificate to the court and that he had another certificate for five shares which tied in precisely with the date of the Alwin Curtain Shop check. Claimant then re- [fol. 183] ferred to Certificate No. 73 for five shares dated the 23rd day of April 1953. Forman then testified that he obtained this stock certificate from Malakoff on April 23, 1953 in exchange for the Alwin check.

According to Forman, prior to March 20, 1953 Malakoff painted a glowing picture of Nazareth. He told Forman that people were paying more than $1200 a share for the stock and that Forman could purchase the stock for $1200 per share. Forman agreed to purchase five shares for $6,000 and this purchase was made on March 20, 1953.

Forman produced photostatic copy of his check for $6,000 payable to Malakoff dated March 20, 1953 and drawn upon the Corn Exchange Bank Trust Company. This check was endorsed by John Malakoff and deposited in the Corn Exchange Bank Trust Company. There is nothing on this check or on the Alwin Curtain Shop check to connect these checks to Nazareth. Forman testified that in order to pay for the stock he obtained a loan for $6,000 from the Astor Place Branch of the Corn Exchange Bank. He produced a paid note signed by him to the Corn Exchange Bank Trust Company for $6,000 dated March 20, 1953. The note states that as security therefor Forman had given to the bank a series of twelve notes of John Malakoff Special for $500 each due "May 2, 1953 through April 2, 1953." An endorsement on the note indicates that a $500 payment was made thereon on May 5, 1953.

Forman also testified that Malakoff was reluctant to sell the stock but agreed to do so on condition that Forman would sell the stock back to Malakoff if he desired it. The final result was that Forman was to borrow $6,000 from [fol. 184] the Corn Exchange Bank Trust Company and Malakoff was to assume the repayment of the $6,000 at the rate of $500 a month, and when fully paid Forman was to return the stock to Malakoff. According to Forman, he was to receive the dividend payments on the five shares at the rate of 20% per annum during the period of the loan arrangement and security represented by the stock.

Malakoff gave the stock certificate to Forman on March 17, 1953 three days before he received the $6,000 check from Forman. He also gave Forman on March 17, 1953, twelve promissory notes for $500 each signed John Malakoff, Special and payable monthly to the order of Harry Forman commencing in May 1953. These were the notes which were all endorsed by John Malakoff and Harry Forman and then given to the bank as security for Forman's

$6,000 loan. Malakoff did pay the first note for $500 and that was the only one that Malakoff paid, so Forman testified.

Forman paid interest to the Corn Exchange Bank on his $6,000 loan. He did not receive any dividends on any of the Nazareth stock that was turned over to him by Malakoff. Forman said that Malakoff told him that he was selling corporate stock. Forman knew that Malakoff was President of Nazareth and Forman stated that he intended to buy stock of Nazareth directly from the corporation. Forman was most emphatic in his statement that his $6,000 check was given to Malakoff in payment of five shares of Nazareth stock represented by Certificate No. 59.

[fol. 185] Stock Certificate No. 59 is dated the 13th day of March 1953, is signed only by John Malakoff and is for five shares and is issued in the name of John Malakoff. The certificate is not signed by the Secretary of Nazareth nor does the corporate seal appear thereon. The certificate is endorsed over to Harry Forman and Jerome Fried is designated as attorney to transfer the shares. The endorsement is dated March 17, 1953 and was signed by John Malakoff. The stub for Certificate No. 59 has the word "security" thereon in two different places. The name "Harry Forman" appears thereon in pencil and the words "cancelled" and "Margolis" appear thereon and are then crossed out.

Certificate No. 73 is dated the 23rd day of April 1953 and is signed by Jerome Fried as Secretary and John Malakoff as President. No seal appears on this certificate. This certificate is for five shares and is in the name of John Malakoff. This certificate was undoubtedly one which had been signed in blank by Jerome Fried. This certificate is also endorsed over to Harry Forman by John Malakoff. The date appearing on the endorsement is April 23, 1953. The stub for Certificate No. 73 has the words "Ben Margolis no deal" and the words "as security." In addition, the words "out" and "cancelled" appear thereon.

Harry Forman signed a questionnaire on the 9th day of February 1954. In this questionnaire Forman was asked to detail his transactions with Malakoff. His answer was as follows:

[fol. 186] "On March 20, 1953 I loaned Malakoff $6,000 he gave me 5 shares of Nazareth stock as collateral security and agreed I was to keep the stock if he defaulted in repayment of this money. On April 23, 1953 I gave him $5,000 more and he gave me an additional 5 shares of stock with the same agreement. On June 2, 1953 he defaulted in the repayment of this money. Therefore according to our agreement I retained possession of the 10 shares of stock."

The issue here, as posed by the debtor, is whether Malakoff made a personal loan from Forman and gave him Nazareth stock as security. The testimony of Harry Forman is contradictory. He engaged in many transactions with Malakoff. Forman gave Malakoff two checks on December 26, 1952, one for $500 and the other for $3500 which checks were endorsed by Malakoff personally and as agent. The $500 check was deposited in the bank account of Ambassador Estates Inc. with the Corn Exchange Bank Trust Company. The $1500 check was deposited in the Malakoff Agent account in the same bank. On the other hand, a check of John Malakoff, Agent for $4,000 was issued to Harry Forman on December 28, 1952. This check was drawn upon the Corn Exchange Bank Trust Company and was certified by Harry Forman and then deposited in his real estate account. This check may have been in exchange for the two checks of $3500 and $500.

Forman received a check for $5,000 of John Malakoff Special dated January 21, 1953 and drawn upon the Bank of the Manhattan Company. Forman testified that this represented repayment of a loan made to Malakoff by Forman. Forman did produce a check for $5,000 dated January 7, 1953 payable to John Malakoff which was endorsed John Malakoff Agent and deposited in the Malakoff [fol. 187] Agent account in the Corn Exchange Bank Trust Company.

Forman received a check for $1500 of John Malakoff Special dated February 10, 1953 and drawn upon the Bank of the Manhattan Company. Forman testified that this check related to a parcel of real estate at 214 Riverside Drive. He said that he and Malakoff became joint venturers in regard to this property, kept it a short while and then sold it at a profit.

Forman produced a $3,000 check to Malakoff dated February 9, 1953 which was deposited in Malakoff's Special account in the Bank of the Manhattan Company, a check for $1500 dated February 19, 1953 payable to the Corn Exchange Bank Trust Company presumably to make good a bad check of Malakoff and a check for $2,000 dated February 4, 1953 payable to the order of Cash which related to Malakoff.

Claimant produced twelve promissory notes of John Malakoff for $700 each and dated October 15, 1951. These notes were signed by Malakoff as Agent and were payable to Harry Forman. Forman testified that these notes were eventually paid by Malakoff without interest and that he received no bonus in connection with the loan which was evidenced by the notes. The seventh and twelfth notes of the series were not paid when they were presented but Malakoff subsequently deposited sufficient funds to cover these notes. Forman said that he lent Malakoff $4,000 three or four weeks before December 28, 1952 despite the fact that the last note in the series of $700 notes had been returned unpaid and Malakoff had to make a deposit in order to make that note good. On the loans theretofore made by Forman to Malakoff, Forman did not request any security.

[fol. 188] It is perfectly plain that the transaction Forman had with Malakoff on or about the 17th day of March 1953 was a security transaction so far as the Nazareth stock was concerned. Malakoff needed money and he agreed to give Harry Forman Stock Certificate No. 59 as security for the repayment of the $6,000. It is likely that Forman received other security. The stock certificate given to Forman by Malakoff, that is Certificate No. 59, was defective on its face. However, on the theory that Forman was dealing with Malakoff and Malakoff intended to give him as security an interest in Nazareth the defective character of the stock certificate is unimportant. The sum of $500 was repaid to Harry Forman. Forman stated that he did not charge Malakoff any interest or bonus with respect to the loans that he made to him. It is reasonably clear, however, on the basis of all the facts that Forman at least received a bonus of $500 in connection with a $5,000 loan

made to Malakoff. The amount of this bonus should be deducted from the balance of $5,500 of the $6,000 loan. The balance of $5,000 was not repaid.

The second deal involving the payment of $5,000 for five shares of stock evidenced by Certificate No. 73 likewise seems to have been a security transaction despite Forman's testimony to the contrary. Still there is no evidence that Malakoff repaid the $5,000 to Forman so Forman would seem to be entitled to an interest in Nazareth to the extent of that $5,000.

Forman advanced $6,000 and $5,000 to Malakoff. The sum of $500 was repaid and the bonus of $500 should be deducted. Accordingly, the sum of $10,000 constitutes the net fair value of the investment of Harry Forman in Nazareth.

[fol. 189] 67. Stock Claim No. 39 for 6 shares was filed by *Richard S. Hull*. This claim is based upon Certificate No. 8 for 4 shares dated the 2nd day of February 1953 and Certificate No. 62 for 2 shares dated the 2nd day of April 1953. The stated consideration for such stock is as follows: claimant's check for $2,400 to Malakoff dated August 25, 1951; claimant's check for $1,200 to Malakoff dated October 4, 1951; and certain legal fees then due or about to become due from Malakoff to claimant. The amount of these legal fees is not stated. No attorney in fact is designated in the claim.

Objections to the allowance of Stock Claim No. 39 were filed by the debtor. These objections allege that Malakoff had no title to the stock delivered to claimant and that no consideration passed to Nazareth. In addition, the debtor by way of counterclaims alleges that claimant is indebted to the debtor in the sum of $4,000, the unpaid subscription price; that by preparing minutes and/or predating the same and participating in a certain transaction involving $11,811.78 claimant assisted in the diversion of assets of Nazareth to that extent and is liable therefor; that claimant conspired and/or participated with Malakoff so as to enable Malakoff to divert Nazareth assets to Malakoff's personal benefit or for the benefit of other ventures in which Malakoff was interested and claimant by reason of

such acts and other conduct became liable to the debtor in the sum of approximately $250,000; and that assets of an indeterminable amount were diverted so as to inure to the benefit of Malakoff personally and the claimant, and [fol. 190] claimant is liable to the debtor therefor. Notice of a hearing on the said objections was given by the Examiner to claimant, to Melvin L. Robbins, Esq., attorney for Robert H. Davidson, Assignee of the Hull claim, and to the attorney for the debtor.

Hull first met Malakoff some time in 1940 or 1941. According to him, he purchased 4 shares of Nazareth stock on August 25, 1951 and 2 shares on October 4, 1951. The price was $1,000 per share which was paid partially by check and partially by balancing off some moneys that Malakoff owed Hull on legal fees.

Hull produced two of his checks payable to the order of John Malakoff and drawn upon the Chase National Bank. One of these checks was dated August 25, 1951 and amounted to $2,400, the other was dated October 4, 1951 and was in the sum of $1,200. The check for $2,400 was endorsed John Malakoff, John Malakoff, Agent and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. The check for $1,200 was endorsed John Malakoff and was likewise deposited in the Corn Exchange Bank Trust Company.

The six shares of stock were purchased by Hull for $600 a share. Hull testified that he reached an agreement with Malakoff to waive anything above $5,000 due him for legal fees in connection with a Springfield Gardens venture, and because of that Malakoff agreed to sell him Nazareth stock at the reduced price of $600 a share.

Hull said that he received dividends of $40 per month from Malakoff in August, September and October 1951 and thereafter received dividends at the rate of $50 per month. [fol. 191] He also testified that he received a series of checks in the sum of $50 each starting on October 1, 1951 and ending on May 1, 1953 with some missing in between. The Siegel, Berg report reflects two payments of $60 each to Hull in February and March 1953 from the Nazareth account in the Second National Bank. Also there were produced and marked in evidence 16 checks of John Mala-

koff, Agent or John Malakoff, Special or John Malakoff each in the sum of $60 payable to the order of Richard Hull. The first check was dated October 1, 1951 and the last check May 1, 1953. A $60 check was issued each month between October 1951 and May 1953 except in September and October 1952 and February and March 1953. The Nazareth checks took care of February and March 1953. Hull did get a check for $75 of John Malakoff, Special on October 1, 1952 and it may be assumed that this check included the $60 dividend payment due in October 1952. It is also reasonable to assume in the light of all the facts that Hull received a dividend payment in September 1952. Of the 16 checks, the first 14 were drawn upon the Corn Exchange Bank Trust Company and the April and May 1953 were drawn upon the Manufacturers Trust Company. On the basis of an investment of $2,400 interest at the rate of 20% per annum would be $480 per year and $40 monthly. If the investment was made on August 25, 1951, the first dividend payment should not have been made to him until about the first of October 1951. His testimony was that he received $40 commencing with August 1951 but he must have been mistaken in his recollection. The check for $1,200 was given to Malakoff on October 4, 1951. Consequently the first dividend on the investment of $3600 would have [fol. 192] become due on or about the first day of November 1951. On the basis of an investment of $3,600 the annual dividend would have been $720 or $60 monthly. The payments made by Nazareth in February and March 1953 reflect interest at the rate of 20% per annum on an investment of $3,600.

The dividend checks for $60 each should not have started at the earliest before November 1, 1951. Malakoff did not pay dividends in advance. It is clear that Hull's first dividend payment from Malakoff for $60 was made on October 1, 1951. That raises a question as to whether the $1,200 check of Richard Hull dated October 4, 1951 was actually given to Malakoff for Nazareth stock. If Malakoff followed his regular practice, he certainly would not have given Hull a dividend on October 1, 1951 based upon an investment of $1,200 which had not then been made and which was made thereafter on October 4, 1951. If Hull did not prior to

October 1, 1951 give Malakoff $1,200 in addition to the $2,400 check of August 25, 1951, then the $60 dividend check on October 1, 1951 can only be explained on the theory that it represented an adjusted dividend on the $2,400 investment for the month of September 1951 and six days in August 1951.

Hull received in all from Malakoff 20 dividend payments of $60 each. Thus the sum of $1,200 was returned to him by Malakoff.

Hull had other transactions with Malakoff. He purchased an interest in the Hotel Margaret either in 1951 or 1952. He received monthly dividend payments of $33.34 on this investment commencing in June 1952. Prior thereto and in April and May 1952 he received monthly payments of [fol. 193] $16.67 from Malakoff. The investment made by Hull in the Hotel Margaret totalled $2,000. Hull gave Malakoff a check for $1,000 on March 21, 1952 and another check for the same amount on April 15, 1952. Both of these checks were endorsed John Malakoff, John Malakoff, Agent and were deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company.

Hull also claimed that he made a loan of $1,000 to Malakoff which was not repaid He testified that for this loan made some time around June 1952 Malakoff gave Hull an additional interest in the Hotel Margaret.

Stock Certificate No. 8 for 4 shares is regular on its face. The stub for this certificate has the word "out" written thereon and then partly crossed over. Stock Certificate No. 62 which is dated the 2nd day of April 1953 and which is for 2 shares is regular on its face but no seal appears thereon. The stub for Certificate No. 62 has nothing thereon to indicate that it was issued subject to any qualifications, conditions or limitations.

The debtor urges that Hull's testimony is contradictory in many respects. The debtor also argues that the fact that Hull was an attorney and director of the debtor during the years this situation developed should be taken into consideration in the allowance of his stock claim. In addition the debtor contends that offsets and counterclaims against Hull should be considered in conjunction with his stock claim.

The record is barren of any testimony to support a charge that Hull was a party to the diversion of Nazareth assets by Malakoff. It is true that Nazareth was entitled to the amount recovered on windstorm insurance. However, [fol. 194] Nazareth was indebted to Malakoff at the time and was in sole control of the operation of the business. Subject to the claims of creditors, Malakoff was entitled to reduce any bona fide indebtedness of Nazareth to him by appropriating the windstorm damage recovery. The so-called back-dating of the corporate minutes do not establish fraud on Malakoff's part in respect of Nazareth nor do they make Hull a party to a fraud upon the corporation.

The problem in regard to the allowance of Hull's stock claim is whether he should be deemed to have paid $6,000 for the 6 shares of stock issued to him or only $3,600. The solution to that problem depends upon whether Hull actually extinguished part of legal fees which were then due and owing to him by Malakoff. Hull wanted a fee of $7,500 on a Bayside deal and it seems that Malakoff offered to sell him Nazareth stock at $600 per share if Hull would limit his Bayside fee to $5,000. The reduction of the fee from $7,500 to $5,000 seems to have been part of a bargaining process and Hull was induced to accept $5,000 because of the opportunity to buy Nazareth stock at $600 per share. Hull actually did not give up $2,500 in legal fees as part consideration for the purchase of the six shares of stock. He paid only $600 per share for the stock and his total investment in the stock was therefore only $3,600. A total of $1,200 was returned to him, as heretofore stated. Accordingly, the sum of $2,400 constitutes the net fair value of the investment of Richard Hull in Nazareth.

[fol. 195] 68. Claim No. 16 for 11 shares of Nazareth stock was filed by *Herbert Danziger* and *Melvin Danziger*. This claim is based on Stock Certificate No. 74 dated the 28th day of April 1953. The stated consideration for this stock was $10,946.97 which had been advanced to Malakoff by claimants in connection with another venture and which Malakoff had agreed to return but had not done so. No attorney in fact was designated in the claim. Objections to the allowance of Stock Claim No. 16 were filed by the debtor and by the Margolis group. The debtor's objections were that Malakoff had no title to the stock issued to

claimants and that no consideration passed to Nazareth. The debtor also asked for an affirmative judgment of $11,000, the unpaid subscription price. The Margolis objections alleged that the stock was issued to claimants conditionally and without any consideration passing to Malakoff. These objections also allege that stock issued to claimants was in excess of the authorized issue of 200 shares. A reply to the Margolis group objections was filed by claimants by Leonard Franklin, Esq. Notice of a hearing on the said objections was given by the Examiner to the claimants, Mr. Franklin, the attorney for the debtor and the attorney for the Margolis group.

Herbert Danciger first met Malakoff some time during 1950. He was introduced to Malakoff by his mother-in-law, Gertrude Klein. The first transaction Herbert Danciger had with Malakoff was about January 1951. In all transactions with Malakoff, Herbert Danciger was a partner with his brother, Melvin, and in negotiations with Malakoff, Herbert acted for himself and his brother.

[fol. 196] The first transaction involved purchase of an interest in the Locust Street Properties in Philadelphia. The Dancigers purchased a 25% interest in that property for $5,500 by check dated January 5, 1951. This check was made payable to John Malakoff and was endorsed John Malakoff, John Malakoff, Agent and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company.

In the early part of 1953, the Philadelphia property was sold and the Dancigers received a check for $6,000. Shortly thereafter, they received another check for two hundred and some odd dollars. In the Philadelphia venture a friend of the Dancigers, Morris Schrier, was also a partner. Evidently the remittance check on the Locust Street Properties was received by Malakoff. He, in turn, issued a check of John Malakoff, Agent for $6,000 to Herbert Danciger on November 14, 1952 drawn on the Corn Exchange Bank Trust Company. Despite the fact that Herbert Danciger testified that the Philadelphia property was sold in the early part of 1953, the record shows that the Philadelphia property was actually sold on October 23, 1952. This ties in with the

$6,000 check from Malakoff to Herbert Danciger dated November 14, 1952.

The next transaction of the Dancigers with Malakoff involved the purchase of a leasehold from him in Roslyn Heights, Long Island, New York, for $12,500. According to Herbert Danciger, he made an initial payment of $1,229.83 for his purchase of the Roslyn Heights venture by means of a check for that amount dated October 16, 1952 payable [fol. 197] to the order of Daniel D. Kantor and drawn upon the Manufacturers Trust Company. He also on October 16, 1952 endorsed over to the Morrisart Realty Corp. his certified check for $7,000 dated October 16, 1952 and drawn upon the Manufacturers Trust Company. In addition, he issued a check for $4,000 on November 17, 1952 to the order of Jack Malakoff and drawn upon the Manufacturers Trust Company. This check was endorsed John Malakoff, John Malakoff, Agent and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company.

The contract closing of the leasehold in Roslyn Heights took place on October 16, 1952. The closing papers provided for the assignment of a leasehold by Baltimore Realty Corp. to Herbert and Melvin Danciger in consideration of the payment of the sum of $12,500. The papers stated that the Dancigers would pay to Malakoff a brokerage commission of $1,500 on or before the 22nd day of October 1952. The passing of title was fixed for a time not later than January 15, 1953. The assignment to the Dancigers was executed by Richard S. Hull as President of the Baltimore Realty Corp. The Baltimore Realty Corp. had acquired title to the leasehold from the Morrisart Realty Corp. on October 16, 1952. As part of that closing the two checks of Herbert Danciger, one for $1,229.83 and the other for $7,000, were used.

Herbert Danciger became interested in the Roslyn Heights property around October 15, 1952. He met Richard Hull for the first time at the closing of the leasehold. In Herbert Danciger's discussion with Malakoff, the latter showed him a brochure which printed a rosy picture of the Roslyn Heights property. This brochure was marked in evidence.

[fol. 198] After the closing of the Roslyn Heights property, Danciger found that the rents were not paid when they became due, that the rent roll was not as represented originally by Malakoff, and that some of the tenants were ready to move out because business was poor and taxes were in arrears. Between October 16, 1952 and March 18, 1953, Danciger had conversations with Malakoff with reference to the representations that Malakoff had made to him. As a result of these conversations Malakoff agreed to collect the rents for Danciger, and later said that he would sell the property for Danciger within 30 days at a profit. Finally Malakoff told Danciger that he would repurchase the Roslyn Heights property from him at cost. Malakoff said that he did not have the money to pay for the property and it was agreed that Malakoff would give Danciger twelve post-dated checks totalling approximately $12,000.

Herbert Danciger and Malakoff executed an agreement whereby both Dancigers assigned their interest in the Roslyn Heights leasehold to Malakoff in consideration of the sum of $11,946.97. This sum was payable $1,000 on April 18, 1953, and a like sum of $1,000 monthly thereafter, except that the last payment should be $946.97. Malakoff agreed to assume all liabilities then outstanding incurred in the operation of the premises and Malakoff was to receive all rents then due and unpaid. Malakoff further agreed to relieve Danciger from any and all liabilities arising from the operation of the premises.

Herbert Danciger said that the first check of Malakoff for $1,000 was returned unpaid because the account was closed. When he reported this fact to Malakoff, he was informed that the account had been closed for business [fol. 199] reasons. Malakoff offered to give Danciger accelerated notes on a new bank, and the first note of the new series given Danciger by Malakoff was payable on April 22, 1953.

The first note was returned unpaid. Danciger again contacted Malakoff and he was then given a check to replace the note. Malakoff at that time also gave Danciger eleven shares of Nazareth stock as collateral for the balance of

the notes which was $10,946.97. This stock certificate was received from Malakoff on April 28, 1953.

The first note must have been paid by check of John Malakoff for $1,005 dated April 23, 1953 payable to the order of Danciger Brothers and drawn upon the Manufacturers Trust Company. This check apparently was first returned unpaid and then on April 27, 1953 was certified by the bank upon which it was drawn.

Stock Certificate No. 74 has the following legends upon the face thereof: "These shares are not saleable *JM* put up as security on R slyn deal." The stock certificate is in the name of Herbert and Melvin Danciger and is signed by Jerome Fried and John Malakoff. The stub for Certificate No. 74 has a number of notations thereon. First there is the word "unpaid" written in pencil. Then the legend "security only not saleable" appears. The word "void" appears on the stub and then seems to be crossed out. Then there is the legend "written on shares". Finally there appears the legend "Re Roslyn". The stub and the certificate clearly indicate that the stock was given to the Dancigers by Malakoff as security for the payment of the moneys owing by Malakoff to the Dancigers.

[fol. 200] According to Herbert Danciger when Note No. 2 for $1,000 was returned marked insufficient funds, he called Malakoff and told him that in view of his agreement he and his brother would consider themselves the owners of the stock which they had originally obtained as collateral. Danciger admitted that he did not get the Nazareth stock when the Roslyn repurchase agreement was executed. He also said that he knew Malakoff was President of Nazareth and that he did not ever pay any money to Nazareth for the stock certificate. Danciger stated that he never received any income, profit or dividend on any of the stock from Nazareth. This is not surprising since Malakoff practically ceased paying dividends in May 1953.

Danciger said that he did not ask Malakoff for security but that Malakoff voluntarily stated that he would give Danciger some stock in Nazareth to secure payment of the loan and if the next note was not paid then the stock would become Dancigers. Danciger said that he received the stock certificate from Malakoff on April 28, 1953.

The debtor maintains that the issue as to the allowance of the Danciger stock claim is whether the transfer of original capital stock of Nazareth in exchange for a personal claim of the Dancigers against Malakoff was proper. The debtor also contends that it was not appropriate for the Nazareth stock to be given as security for a personal indebtedness of Malakoff to the Dancigers and that, in any event, the stock could not properly have been given to the Dancigers for a past consideration. In the view of the [fol. 201] Examiner, it is immaterial whether the consideration to Malakoff was past or present. Admittedly no present consideration passed to Malakoff when the stock was given to the Dancigers as security. Furthermore, whether the stock was given as collateral security or in satisfaction of an indebtedness of Malakoff to the stockholder is irrelevant.

There was undoubtedly an indebtedness of Malakoff to the Dancigers. That indebtedness was created by the agreement of March 18, 1953 between the Dancigers and Malakoff, if a liability in favor of the Dancigers did not exist prior thereto. Moreover, Malakoff was liable to the Dancigers on the unpaid promissory notes. There is no evidence in the record to support a finding that the Dancigers conspired with Malakoff to deprive the other stockholders of any rights they enjoyed at the time the Dancigers received the stock certificate from Malakoff.

The Dancigers had a claim against Malakoff for $10,946.97. There is no evidence that any part of that claim was paid by Malakoff. Accordingly, the sum of $10,946.97 constitutes the net fair value of the investments of Herbert and Melvin Danciger in Nazareth.

69. Claim No. 2 for 3 shares of Nazareth stock was filed by *Leslie Saul*. This claim is based upon Stock Certificate No. 20 dated the 2nd day of February 1953. No attorney in fact was designated in the claim.

[fol. 202] Objections to the allowance of Stock Claim No. 2 of Leslie Saul were filed by the debtor and by Benjamin Margolis, et al. The objections of the debtor charged that Malakoff had no title to the stock that was issued to the claimant and that no consideration passed to the debtor. The debtor pleaded a counterclaim in which it prayed for

judgment of $3,000, the alleged unpaid subscription price of the stock. The Margolis objections attempted to incorporate as objections to the Saul claim the objections that had been filed by the debtor to the allowance of the claims of the Margolis group. Claimant Saul filed a reply to the debtor's objections in which she alleged that she had purchased her stock from Nazareth and paid therefor by check given to Malakoff as Agent for Nazareth. Notice of a hearing on said objections was given by the Examiner to the claimant and other parties in interest, including Herman L. Falk, Esq., who had filed a reply for claimant.

Leslie Saul first testified that she met Malakoff in 1952. At that time he told her that he had 200 shares of Nazareth stock and that he intended to sell 100 shares thereof and retain the balance. Later she testified that she knew Malakoff six months prior to September 18, 1951 and that she had had one business transaction with him. That transaction involved an investment of $400 on her part and with respect to which she received a $250 profit represented by a check of John Malakoff Agent for that amount dated July 14, 1951 and drawn upon the Corn Exchange Bank Trust Company. Over the endorsement of Leslie Saul on this check, however, appears the following: "Re Bleeker-Exchange".

[fol. 203] In addition she testified that a couple of months prior to September 18, 1951 Malakoff approached her through a friend and tried to interest her in Nazareth. Malakoff, at their first meeting, told claimant that he owned 200 shares of Nazareth, that a corporation had been organized and that the stock had been issued to him. Malakoff told her that she was to get 3/200ths of the stock for $3,000 and that these three shares would come from the 100 shares that he intended to sell. It was agreed that the price per share would be $1,000.

Claimant was mistaken in her original testimony that she first spoke to Malakoff about Nazareth stock in 1952 for she produced a check for $3,000 dated September 20, 1951 payable to the order of John Malakoff which she said represented the purchase price of three shares. This check was drawn on the Clinton Trust Company, New York, and was endorsed John Malakoff, John Malakoff, Agent and

was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Over the endorsement appears the word "Nazareth".

Claimant testified that she went to Malakoff's office and delivered the $3,000 check to him on September 21, 1951 and that testimony undoubtedly is correct. She said that Malakoff gave her a letter stating that he would send the stock certificate to her without specifying the time when this would be done and she produced a letter dated September 18, 1951 signed by John Malakoff. This letter acknowledged receipt of $3,000, stated that dividends at the rate of 20% per annum payable monthly had been declared and [fol. 204] indicated that the corporation might be dissolved and a limited partnership substituted therefor, in which event Leslie Saul would have an interest therein proportionate to her investment. The letter also stated that the total shares issued were 200 and that she had a 3/200th part of the deal.

According to claimant, about a month after making the investment of $3,000 she commenced to get dividends on her $3,000 investment at the rate of 20% per annum payable monthly. Claimant received $50 checks monthly of John Malakoff, Agent or John Malakoff, Special drawn upon the Corn Exchange Bank Trust Company commencing with November 1951 and continuing through January 1953, as evidenced by cancelled checks which were marked in evidence. Claimant also received $50 checks of Nazareth in February and March 1953 drawn upon the Second National Bank of Nazareth, Pennsylvania. In addition, claimant received $50 checks of John Malakoff in April and May 1953 drawn upon the Manufacturers Trust Company. Thus claimant received a total of $950 in so-called dividends.

Claimant received Stock Certificate No. 20 through the mails from Malakoff on or about February 2, 1953. Neither at the time the $3,000 was given to Malakoff nor at the time of the receipt of the stock certificate, so Saul testified, did Saul have any knowledge of any irregularity in connection with the issuance of stock certificates of Nazareth nor of any overissue of stock. The stub for Stock Certificate No. 20 is regular on its face and there is nothing thereon to indicate that it was issued subject to any conditions, qualifications or restrictions.

[fol. 205] Leslie Saul invested $3,000 with Malakoff for 3 shares of Nazareth stock. This investment was made in good faith despite the fact that there is no proof that the consideration passed to Nazareth. The evidence is far from convincing that the $3,000 check of claimant was given to Malakoff in his capacity as Agent for Nazareth. That, however, is immaterial. Claimant invested $3,000 and the sum of $950 was returned to her in so-called dividends. Consequently the sum of $2,050 constitutes the net fair value of the investment of Leslie Saul in Nazareth.

70. Claim No. 5 for 3 shares of Nazareth stock was filed by *Jerome Fried*. This claim is based upon Certificate No. 15 dated the 2nd day of February 1953 in the name of Jerry Fried. The consideration for the stock is not set forth in the proof of claim. Meyer Kraushaar, Esq., 42 Broadway, New York 4, New York, was designated as attorney in fact for claimant. Jerome Fried also filed a creditor's claim in the sum of $17,326 with respect to which Meyer Kraushaar, Esq. was also designated as attorney in fact. The stated consideration for this claim is as follows: weekly wages—$13,200; expense of maintenance of automobile—$1840; commissions on gross income of business for the year commencing June 20, 1952 and ending June 19, 1953—$1640; and commissions on gross income of business from June 20, 1953 to September 28, 1953—$646. Such claim is based upon an alleged agreement made by Jerome Fried with Malakoff prior to June 20, 1952. This report [fol. 206] deals with Jerome Fried's stock claim and the testimony adduced at the hearings relating to the creditor's claim is discussed only to the extent that such testimony bears upon the allowance of the stock claim.

Objections to the allowance of the stock claim of Jerome Fried were filed by the debtor. These objections were as follows: Malakoff had no title to the stock which was issued to claimant for balances due claimant for personal indebtedness purportedly owed by Malakoff to the claimant; that no consideration passed to Nazareth; that Fried violated his trust as a director and officer of Nazareth and caused damage to the debtor in the sum of $10,000; that Fried knew or should have known that Malakoff was selling the capital

stock of the debtor and was not turning over the proceeds to Nazareth with the result that Nazareth was damaged in the sum of $250,000; that claimant cooperated with Malakoff in diverting the sum of $11,811.78 from Nazareth; that claimant actively and passively conspired with Malakoff or so conducted himself as an officer and director to enable Malakoff to divert other assets of Nazareth in an undeterminable amount, for which an accounting is requested; and that claimant and Malakoff participated in the diversion of corporate assets and claimant breached his trust as a director and officer by the assignment to claimant or a corporation controlled by him of a lease that was not in the best interests of Nazareth. The debtor prayed for an affirmative judgment against claimant in respect of the aforesaid matters to the extent appropriate. [fol. 207] Notice of a hearing on the said objections was given by the examiner to claimant and to the attorney for the debtor. No notice was given to Meyer Kraushaar, Esq. but Jerome Fried appeared in person at the hearings on the objection to the allowance of his stock claims and his creditor's claim and made no objection to lack of notice to his designated attorney in fact. Claimant was given an opportunity to obtain counsel to represent him at these hearings.

Jerome Fried testified that he became manager of the Nazareth Farmers Market in June 1952 and continued in that capacity under the direction of Malakoff until about June 29, 1953. Thereafter Fried continued as manager under the direction of Arnold Weinstein who had become president of Nazareth. He was acting as manager of the market on September 28, 1953 when the reorganization petition was filed and he has continued as manager since that date.

According to Fried, in 1950 he acquired an interest in certain property known as 96 Warren Street, New York. This property was purchased by him through Malakoff from Seymour Forman. He made a down payment of $1,000 and title was taken in his name and he managed the property and collected the rents until the winter of 1951 when the property was sold. At the time of the resale, Fried was to get back the $1,000 invested by him plus a profit of

$2100. He received the return of his principal of $1,000 but a check for $2100 of the purchaser representing the profit was turned over to Malakoff.

[fol. 208] Fried's testimony is that some time in August or September 1951 he told Malakoff to apply the $2100 towards an interest in Nazareth but he did not receive a receipt from Malakoff. He did get monthly dividend checks of $33.34, based on a $2,000 investment, and later he got Stock Certificate No. 15 for 3 shares of Nazareth stock.

Fried said that he was not told originally by Malakoff that Nazareth stock was being sold for $1,000 a share and did not know the number of shares he would get for his $2100 investment. Fried only knew what he would get monthly by way of dividends. Fried testified that he was only interested in the 20% return on the $2,000 investment and did not regard as meaningful the fact that he would receive three shares of stock.

Fried was positive that no part of the $2100 was returned to him by Malakoff. Any checks that read "obtained from Malakoff" represented such transactions as exchanges, commissions or salaries or possibly represented checks that he had cashed for Malakoff.

The first so-called dividend check that Fried received was one for $33.34 dated October 1, 1951, signed John Malakoff, Agent and drawn upon the Corn Exchange Bank Trust Company. Over the endorsement of Jerry Fried appears the word "Nazareth" in dark ink as contrasted with the endorsement and the writing on the face of the check which appears in light ink. It is likely that this check actually represented a return from a $2,000 investment in Nazareth. Thereafter and each month from November 1951 through January 1953 claimant received a check of John [fol. 209] Malakoff Agent or John Malakoff Special drawn on the Corn Exchange Bank Trust Company for $33.34. The word "Nazareth" appears over the endorsement of Jerry Fried on several of these checks. Fried received checks for $50 of Nazareth in February and March 1953 drawn upon the Second National Bank of Nazareth. In addition, he received a check of John Malakoff for $33.34 dated April 1, 1953 drawn upon the Manufacturers Trust Company. There is no evidence that Fried received any

dividend checks that cleared subsequent to the April 1953 check. Thus Fried received a total of $633.46.

Stock Certificate No. 15 for three shares is regular on its face. The stub for Stock Certificate No. 15 carries the legend "out". No explanation was offered as to the significance of this legend.

Fried testified that he engaged in various loan and exchange transactions with Malakoff. He knew that the market was owned by a corporation at the time he made his investment in Nazareth through Malakoff. Despite this fact he handled the negotiations under which his father acquired Nazareth stock and the check for this stock was made payable to Malakoff and not to the corporation.

Fried denied that he was a director of Nazareth in October 1951 and yet as a director he signed minutes of a meeting of directors allegedly held on October 17, 1951. He testified that these minutes were actually signed by him some time in May or June 1953. The same thing happened with respect to minutes of a meeting allegedly held on June 27, 1952.

[fol. 210] According to Fried, in January 1953 he signed a number of stock certificates of the debtor in blank. At the time he signed these certificates there were no other signatures on them. His signature was appended to the certificates as Secretary of the corporation.

Fried insisted that he did not draw any salary from Nazareth although he admitted that he received money from Malakoff personally on several occasions. So far as Fried knew, no money given to Malakoff for the purchase of Nazareth stock actually went into a bank account of the debtor.

So far as Fried's stock investment is concerned, it is reasonable to assume on the basis of all the evidence that Fried made an investment of $2,000 with Malakoff for the purpose of getting Nazareth stock. Fried was not interested in the number of shares of stock he would get but rather than in a return of 20% per annum on his investment. No dividends were earned or declared by Nazareth. The sum of $633.46 in capital was returned to Fried. Subject to the determination of the court with respect to the allowance of Fried's creditor claim, and subject to the resolution by

the court of the so-called affirmative defenses and counterclaims asserted by the debtor, the sum of $1,366.54 constitutes the net fair value of Jerome Fried's investment in Nazareth.

71. Claim No. 8 for 15 shares of Nazareth stock was filed by *Seymour Forman*. This claim is based upon Certificate No. 49 dated the 12th day of March 1953 issued in the name of John Malakoff and endorsed by him over to Seymour Forman. The proof of claim simply states that this stock [fol. 211] certificate was transferred to claimant by Malakoff "For good and valuable consideration." This proof of claim was sworn to the 28th day of February 1955 and was filed with the Honorable John E. Joyce, Referee in Bankruptcy, on the 28th day of February 1955. Claimant also filed with Referee Joyce on the 28th day of February 1955, a proof of claim for $5,000. The stated consideration for this claim is as follows: "A promissory note, dated March 12, 1953, made payable to the order of claimant on July 13, 1953, with interest at 6% per annum at Second National Bank, Nazareth, Pa., for moneys loaned by claimant to the said debtor." Louis R. Patur, Esq. was designated attorney in fact for the claimant in each proof of claim.

The debtor filed objections to the allowance of Stock Claim No. 8 of Seymour Forman upon the following grounds: that Malakoff had no legal title to the stock certificate which was delivered to claimant for balances allegedly due claimant for personal indebtedness purportedly owing by Malakoff to claimant; that no consideration passed to Nazareth; that the stock certificate held by Forman is void; that the stock was delivered by Malakoff to claimant as security for personal indebtedness from Malakoff to claimant; that claimant is not a purchaser for value in that claimant received from Malakoff more moneys than claimant loaned to Malakoff and any balance due from Malakoff personally to claimant resulted from transactions contrary to the public policy of the State of New York; that claimant loaned Malakoff personally or to Wales Corporation or Ambassador Estates Inc. the sum of $10,000 in August 1952, that claimant received two notes for $5,000 each therefor, one from Wales Corporation and the other from Ambassa-

[fol. 212] dor Estates, and that claimant or his daughter (actually his wife), Yvette B. Forman, thereafter, received payments in excess of the amount loaned, and that in March 1953 claimant received the certificate for 15 shares of Nazareth stock as security for the $10,000 loan and $5,000 then loaned to Malakoff personally; and that the stock received by claimant represents overissued stock. The debtor also in the alternative demands judgment against Seymour Forman in the sum of $15,000.

Objections to the allowance of Stock Claim No. 8 were also filed by the Margolis group. These objections attempted to incorporate as objections to the Forman stock claim objections theretofore filed by the debtor to the allowance of the stock claims of the Margolis group. These objections also alleged that the certificate held by claimant constituted stock in excess of the authorized issue of 200 shares; that the 15 shares were issued to secure the payment of $5,000 and that 10 shares should be returned or $10,000 paid to the debtor.

The debtor also filed objections to the allowance of Forman's creditor's claim No. 15. These objections allege that no consideration was given to the debtor for the debtor's note on which the $5,000 claim is predicated; that the note is void under Pennsylvania law; that claimant was paid for the note; that the note was given as collateral security for personal obligations owed to claimant by Malakoff personally; and that the stock of the debtor held by claimant is either void or voidable.

[fol. 213] Claimant filed a paper denominated "Answer of Seymour Forman to objections filed against his claim as a Stockholder." Claimant alleged that he received Certificate No. 49 for 15 shares of Nazareth stock as an inducement to renew promissory notes of Ambassador Estates Inc. and Wales Properties Inc. and to make an additional loan of $5,000 to Nazareth; that these notes were not paid when due; that appropriate actions were instituted in the New York City court on the three promissory notes; that the actions were tried on the merits on January 18, 1954 and judgments were entered against Malakoff individually and against Ambassador Estates, Inc. and Wales Properties, Inc. and not against Nazareth because of the pendency of

this proceeding; and that by virtue of the default in the payment of the three notes claimant became a bona fide stockholder of Nazareth to the extent of 15 shares. This answer also alleged that all holders and owners of Nazareth stock were equal victims of the machinations of Malakoff; that all should share equally as such victims; and that none should benefit more than any other because he was fleeced more expertly or less expertly than others by Malakoff. The answer further alleged that the assets of Nazareth were sufficient to recognize all stockholders on equal footing, i.e., on the basis of $1,000 per share, and that the net worth of Nazareth appears to be sufficient to recognize each share of stock for the full or nearly full value.

Claimant also filed an answer to the objections of the Margolis group in which, among other things, claimant challenged the right of the Margolis group to object to the [fol. 214] allowance of his claims. Notice of a hearing on said objections was given by the Examiner to claimant, to Louis R. Patur, Esq. and to other parties in interest.

Seymour Forman testified that he had known Malakoff since 1938 and that in the course of his acquaintanceship with Malakoff had engaged in various business ventures with him. These business ventures included loans of money to Malakoff from time to time. Forman received Stock Certificate No. 49 from Malakoff on March 12, 1953. This stock certificate, as heretofore stated, was issued in the name of John Malakoff and was endorsed over to Seymour Forman by John Malakoff. There is no date on the endorsement but the certificate is dated the 12th day of March 1953 and is signed by John Malakoff as President and Jerome Fried as Secretary. The stub for Stock Certificate No. 49 reads as follows: "Issued to John Malakoff Held as security void 3/12/53." The word "void" is written over the date and at the bottom thereof appears the following in pencil "Harry Forman now". The initials HB appear alongside of the word "out" which is crossed out in pencil, the word "security" appears in ink at the top of the stub and the stub seems to indicate that the certificate was written originally for 5 shares and then increased to 15. No explanation was offered as to the significance of the markings on the stub.

When Forman received the stock certificate on March 12, 1953, he signed a paper written out by Malakoff, which was signed by both Forman and Malakoff. This paper recited that Malakoff had given to Seymour Forman Agt. fifteen shares of Nazareth stock to be held as security for $15,000 [fol. 215] loaned by Seymour Forman Agent and evidenced by three promissory notes for $5,000 each of Wales, Ambassador and Nazareth. This paper also stated that Forman had received the stock, that the shares were to be returned when the notes were paid and were not saleable or transferable.

Forman testified that Malakoff asked him for a loan of $5,000 for Nazareth on March 12, 1953 and that Forman gave him the money and received a note in return. Claimant produced a promissory note of Nazareth by John Malakoff, President for $5,000 dated March 12, 1953 payable on July 13, 1953 to Seymour Forman at the Second National Bank, Nazareth, Pennsylvania. This note was endorsed by John Malakoff individually and appears not to have been paid when it became due. Forman claimed that he gave Malakoff $5,000 in cash. This cash, he said, was obtained as follows: A $1900 check was cashed at the Marine Midland Trust Company, he had $1600 in cash with him and he was given a bonus of $500 each on his Nazareth loan and for extending $5,000 loans to Ambassador and Wales. Thus the actual cash claimed to have been advanced by Forman to Malakoff at the time was $3,500.

Claimant produced a bank statement of the Marine Midland Trust Company on an account in the name of Seymour Forman Agent showing the withdrawal of $1900 on March 13, 1953. When the Nazareth note became due Forman instituted an action in the New York City Court against Malakoff and Nazareth because the note was not paid. Nothing was done against Nazareth thereafter because of the filing of the reorganization petition.

[fol. 216] According to Forman, he made a loan of $5,000 to Ambassador Estates on August 28, 1952. This loan was made in the form of a check of Seymour Forman Agent payable to the order of the Ambassador Estates, Inc. drawn upon the Marine Midland Trust Company. This check was endorsed Ambassador Estates, Inc. and was deposited in

the Corn Exchange Bank Trust Company. Forman testified that he received a promissory note from Ambassador Estates, Inc. in connection with the loan. This note was payable on March 12, 1953. When it became due Malakoff stated that he could not pay it and this note was destroyed and a new note dated August 28, 1952 payable July 3, 1953 was given by Ambassador Estates, Inc. to Forman. The note produced by Forman, which was never paid, was signed Ambassador Estates, Inc., John Malakoff, President, was dated August 28, 1952 and was payable to the order of Seymour Forman Agent on July 3, 1953. This note was endorsed personally by John Malakoff. Forman said that he received a bonus of $250 in cash from Malakoff when he made this $5,000 loan to Ambassador Estates, Inc.

Forman further testified that he made a $5,000 loan to Wales Properties Inc. on August 28, 1952 in the form of a check of Seymour Forman Agent drawn upon the Marine Midland Trust Company. This check was endorsed Wales Properties, Inc. and was deposited in the Irving Trust Company. Forman produced a promissory note of Wales Properties, Inc. which he said he received from Malakoff on March 12, 1953 to take the place of a note for $5,000 payable March 12, 1953 which had been given to him on August 28, 1952. This note is signed Wales Properties, Inc., John Malakoff, President, and is payable to Seymour Forman [fol. 217] Agt. on July 3, 1953. This note was endorsed personally by John Malakoff. Forman said that he received a bonus of $250 from Malakoff either in cash or by check in connection with this loan.

Forman contends that no part of the three $5,000 loans was ever repaid to him. Forman was confronted with eleven promissory notes for $300 each payable monthly commencing with January 1952 signed by John Malakoff Agent to the order of Yvette B. Forman and he testified that these notes were part of a larger series, the first eleven of which (probably for $100 each) were paid by Malakoff. Forman said that he received those payments as well as payment of the notes which were produced but that these payments covered a completely different loan which was made to Malakoff on January 22, 1951.

Claim No. 15 is based upon the Nazareth promissory note for $5,000 dated March 12, 1953 payable July 13, 1953. This promissory note is also part of the consideration for the transfer of Certificate No. 49 by Malakoff to Forman. The claims may therefore be regarded as alternative claims. If Stock Claim No. 8 is disallowed Forman stands upon his creditor's claim No. 15. If creditor's claim No. 15 for $5,000 is disallowed it may be possible for Stock Claim No. 8 to be allowed, depending upon the reason for disallowance of Stock Claim No. 15. There is some doubt as to whether Seymour Forman advanced any moneys to Malakoff on March 12, 1953. Forman has testified that he advanced $3,500 and the promissory note of Nazareth for $5,000 creates a presumption that some moneys were actually ad- [fol. 218] vanced. There is nothing in the record to refute Seymour Forman's positive assertion that he gave Malakoff $3,500 in exchange for the $5,000 note. It therefore must be assumed that the consideration for the issuance of the note was $3,500. However, there is nothing in the record to support a finding that any part of this $3,500 reached Nazareth. The money was given to Malakoff in cash and beyond that it has not been traced. Therefore claim No. 15 standing alone should be allowed only to the extent of $3,500.

The next question is whether Seymour Forman is entitled to Stock Certificate No. 49 or for any shares of stock in Nazareth. His claim to the stock rests upon the agreement of March 23, 1953 signed by Malakoff and Forman. It is doubtful that the promissory notes dated August 28, 1952 of Wales Properties, Inc. and Ambassador Estates, Inc. payable to the order of Seymour Forman Agt. on July 3, 1953 were actually given to Seymour Forman by Malakoff on March 12, 1953, as Forman has testified. The evidence as a whole supports the conclusion that these two notes were given to Forman by Malakoff on August 28, 1952 when the $5,000 loans were allegedly made to Ambassador Estates, Inc. and Wales Properties, Inc. Forman has admitted that he actually advanced a total of only $9,500, although it is a fair assumption that the bonuses exceeded $500. In any case, whether the notes were given on August 28, 1952 or

March 12, 1953 does not seem to be material. The Ambassador and Wales notes were not due on March 12, 1953 but as a condition of the $3500 loan to Nazareth, it is clear that Forman insisted upon getting security for the Ambassador and Wales notes as well as the Nazareth note. The security [fol. 219] consisted of Certificate No. 49 for 15 shares of Nazareth stock. Malakoff had endorsed the Ambassador and Wales notes and therefore was liable to Forman if they were not paid.

Viewing the March 12, 1953 transaction in the light most favorable to Forman, he received 15 shares of Nazareth stock for $13,000. Upon the assumption that Malakoff was in complete control of the stock of Nazareth and that it was immaterial whether the consideration passing to him for Nazareth stock was a present or antecedent one, it may be said that the sum of $13,000 constitutes the net fair value of the investment of Seymour Forman in Nazareth. The alternative creditor's claim No. 15 must of course be disallowed.

72. Claim No. 25 was filed by *Eskandar Manoochehrian*. This claim is based upon Certificate No. 36 for 14 shares of Nazareth stock dated the 2nd day of February 1953 and Certificate No. 63 for 6 shares of Nazareth stock dated the 10th day of April 1953. The stated consideration for this stock is as follows: claimant lent $20,000 to Wales Properties, Inc. on November 14, 1952. On November 18, 1952 claimant received the sum of $33.33 from Malakoff. On December 10, 1952 Malakoff agreed to repay the said sum of $20,000 in seven weekly payments of $2,857.14 each, commencing December 17, 1952. Malakoff paid claimant $2,857.14 on December 17, 1952 and $2,857.14 on December 26, 1952. No further payments were made to claimant on this indebtedness. On February 2, 1952 Malakoff delivered to claimant Certificate No. 36. Claimant refused to accept [fol. 220] fourteen shares in full payment of the indebtedness. On April 10, 1953 Malakoff delivered to claimant Certificate No. 63. Claimant agreed to accept 20 shares of Nazareth stock in payment of the indebtedness to him from Wales Properties, Inc. No attorney in fact was designated in the proof of claim.

Objections to the allowance of Claim No. 25 were filed by the debtor and by the Margolis group. The debtor alleged that Malakoff had no title to the stock that was transferred to claimant and that no consideration passed to Nazareth. The debtor also asserted a counterclaim against claimant in the sum of $20,000. The Margolis objections also claim that neither the debtor nor Malakoff received any consideration for the stock and that the stock issued to claimant was in excess of the authorized stock. Claimant filed a reply to the debtor's objections by Solomon Gilbert, Esq., 295 Madison Avenue, New York. Notice of a hearing on said objections was given by the Examiner to claimant, Solomon Gilbert, Esq. and the attorneys for the debtor and the Margolis group.

Claimant made a loan of $20,000 to Wales Properties, Inc. by check dated November 14, 1952. This check was deposited in the account of Wales Properties, Inc. in the Irving Trust Company. Claimant was able to make this loan because Malakoff had gradually repaid a prior loan to him for $10,000 by two checks for $2500 each, one dated November 6, 1952 and the other November 12, 1952 and by one check for $5,000 dated November 14, 1952. Malakoff did in fact receive a check for $10,000 from Manoochehrian [fol. 221] dated October 11, 1952 and drawn upon the Irving Trust Company. This check was endorsed John Malakoff, John Malakoff, Agent and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Manoochehrian received a check dated November 6, 1952 for $2500 of John Malakoff, Agent and a check for the same amount of John Malakoff, Agent dated November 12, 1952. Both of these checks were drawn upon the Corn Exchange Bank Trust Company. The Manoochehrian records show that he also received a check for $5,000 from John Malakoff on November 14, 1952. Actually this $5,000 payment was a check for that amount dated November 14, 1952 on the account of Wales Properties, Inc. drawn on the Irving Trust Company.

When Manoochehrian gave Malakoff his check for $20,000 on November 14, 1952 he received a promissory note for that amount of Wales Properties, Inc. payable on or before January 20, 1953. This note was endorsed as follows:

"John Malakoff, Ambassador Estates, Inc., John Malakoff, Pres., Nazareth Fair Grounds & Farmers Market, John Malakoff, Pres., Baltimore Realties Inc., John Malakoff, Pres."

On or about November 18, 1952, Manoochehrian received a check from Malakoff for $33.33. He claimed that apart from the $10,000 returned to him by Malakoff, this check for $33.33 represented the only moneys received by him from Malakoff prior to December 10, 1952. The records of Manoochehrian indicate that this check for $33.33 represented interest but there is no indication as to the amount of the loan to which it applied.

[fol. 222] Manoochehrian testified that he had a conversation with Malakoff on December 10, 1952 at which time they discussed repayment of the $20,000 loan to Wales Properties, Inc. In this conversation an agreement was reached under which Malakoff was to repay the $20,000 in seven weekly payments of $2,857.14 each, commencing December 17, 1952. This understanding was reduced to writing and was signed by Malakoff.

Thereafter Manoochehrian received two payments of $2,857.14 each. One payment was made on December 17, 1952 and the other on December 26, 1952. Both of these payments were made by checks of John Malakoff Agent drawn upon the Corn Exchange Bank Trust Company. The second check was certified. According to Manoochehrian, he did not receive any further payments against the $20,000 loan to Wales Properties, Inc. Manoochehrian also testified that he received post-dated checks from Malakoff on December 10, 1953 and that the unpaid checks were returned to Malakoff later when he received Nazareth stock.

When the third check was due, so Manoochehrian testified, Malakoff told him not to deposit it since there was no money in the account. This was some time in the beginning of 1953. Malakoff told Manoochehrian that instead of meeting the post-dated checks in accordance with the agreement of December 10, 1952, he would prefer to give Manoochehrian shares in Nazareth and Manoochehrian agreed to drive to Nazareth to inspect the market. Manoochehrian went to Nazareth to inspect the market and there he saw Jerome Fried. Fried's sister was married

[fol. 223] to Manoochehrian's brother. After visiting Nazareth and later in the month of January, Manoochehrian visited Malakoff at his office. Malakoff then told him that he still did not have the money to repay the debt and that he would give him stock in Nazareth at the rate of $1,000 per share, which was the price at which such stock was being sold. Manoochehrian agreed to accept fourteen shares of Nazareth stock for which he received Stock Certificate No. 36.

Stock Certificate No. 36 is regular on its face. The stub for that certificate shows that it was issued to Eskandar Manoochehrian but also has thereon the following legends "security" and "John Malakoff—security". The stub therefore tends to contradict claimant's testimony that he received the stock certificate in satisfaction of the balance due on the $20,000 note of Wales Properties, Inc. In any case, there seems to be no question but that the stock certificate was actually issued in the name of Manoochehrian and delivered to him.

Manoochehrian testified that after receiving Stock Certificate No. 36, he heard that shares were being sold for $600 a share instead of $1,000 a share and he complained to Malakoff about having to pay $1,000 per share. As a result of his persistence, Malakoff agreed to give Manoochehrian another six shares, for which Manoochehrian received Stock Certificate No. 63. This certificate, so Manoochehrian testified, was received by him on April 10, 1953, the date the certificate bears. Manoochehrian said that when he received Certificate No. 63, Malakoff called Helen Bernstein into his office and told her that he was giving Manoochehrian six more shares of Nazareth stock and that [fol. 224] this cancelled out his debt to Manoochehrian.

Stock Certificate No. 63 is also regular on its face. The stub for this certificate is regular on its face and does not indicate that it was given to Manoochehrian as security. In fact, there are no restrictions, conditions or limitations of any kind on the stub. This stub therefore supports the testimony of claimant.

After receiving the stock certificates, Manoochehrian returned the unpaid post-dated checks to Malakoff. It is significant that these post-dated checks were all signed by

Malakoff and not by Wales Properties, Inc. Malakoff did not ask Manoochehrian to return the promissory note so Manoochehrian retained the same.

Either when Manoochehrian received the stock certificate for 14 shares or the certificate for 6 shares, Malakoff gave him a letter receipt for $16,000 dated November 14, 1952. The significance of this receipt is that it bears the same date as the date of the original loan to Wales, even though it was given to Manoochehrian in February or April of 1953.

On May 6, 1953 Manoochehrian received a check of John Malakoff dated May 1, 1953 for $177.78 drawn upon the Manufacturers Trust Company. According to Manoochehrian, this was the only money he received from Malakoff in 1953. The receipt of this check by Manoochehrian is reflected upon his records but there is no indication thereon as to what it represented. Manoochehrian testified [fol. 225-6] on cross-examination that this check was supposed to represent a dividend on Nazareth stock at the rate of 20% per annum. This amount was short of 20% on $16,000 for a full month and would seem to indicate that Malakoff actually owed Manoochehrian less than $16,000 at the time.

Some time in 1953, after Malakoff had given him the second stock certificate, Malakoff came to Manoochehrian's office and offered to sell him $700 or $800 worth of notes for a much smaller sum. Manoochehrian testified that he bought these notes for less than half the amount they represented and that subsequently he received payment for two of these notes. These notes were for $65 each and evidently were made by one Danciger. The remaining notes were not paid and thereafter Manoochehrian made a settlement with Danciger with respect thereto.

Manoochehrian joined with his brother, Manoochehr Manoochehrian, in transactions with Malakoff. He did not recall receiving anything from his brother which might have been received from Malakoff as a result of transactions with Malakoff. He did recall that in the beginning of 1953 a check for $3,000 was made out by his brother to the order of Malakoff and was endorsed by Malakoff and then given to him (Eskandar) and he deposited it in his bank. His

brother told him, however, that this was a mistake and did not represent a payment to Eskandar from Malakoff but was a payment of a debt from Manoochehr to Eskandar. It is odd that a payment by Manoochehr to his brother Eskandar should have been made through Malakoff but [fol. 227] there is no evidence to refute the explanation offered by Eskandar Manoochehrian.

Claimant testified that the $10,000 loan made by him to Malakoff in October 1953 was made without the receipt of any bonus, security or collateral. This testimony is difficult to accept but there is no evidence in the record to refute it.

Manoochehrian testified on cross-examination that the $20,000 check payable to Wales Properties, Inc. and dated November 14, 1952 was given to Malakoff for investment in a 69th Street parcel of property. That testimony contradicts the statement in Manoochehrian's claim that the $20,000 represented a loan to Wales Properties, Inc. Manoochehrian explained the contradiction by saying he hoped Malakoff would put the $20,000 into the 69th Street property and that when this did not materialize and he did not get his money back, Malakoff offered him shares in Nazareth which he agreed to accept.

Manoochehrian testified that he knew that Malakoff was President of Nazareth and assumed that he owned all the stock in that company. He admitted, however, that Malakoff did not tell him that he owned the corporation.

In April 1953 there was due to Manoochehrian from Malakoff the sum of $14,285.82. In fact, Manoochehrian testified that in January 1953 there was Fourteen Thousand some odd dollars owing to him from Malakoff and on February 2nd he received fourteen shares of stock valued at $14,000 in payment of the $14,000 debt.

[fol. 228] Alex Rosen testified that he found a memorandum among the effects of Malakoff which was received in evidence and read as follows: "Also paid Jan. 2, 1953— 2857.14 all 357.00 were paid in *cash*". Other than this memorandum, Mr. Rosen had no record, memorandum or evidence indicating any payment to Manoochehrian on January 2, 1953 of $2,857.14. Manoochehrian testified that he did not remember any transactions with Malakoff involving pay-

ment of $357, and that so far as he recalled he did not have any such transaction.

The transcript of Manoochehrian's bank account with the Irving Trust Company for January 1953 does not reflect the deposit therein of $2,857.14. It shows three deposits in January, one on January 12 for $1,000, another on January 14 for $3,000 and another on January 23 for $147.75. The sum of $2,857.14 might have been included in the deposit of $3,000 on January 14 but that does not seem to be important. Manoochehrian testified that he received two checks from John Malakoff in December 1952, each in the sum of $2,857.14, one on December 17 and the other on December 26, but the transcript indicates that only one deposit in that amount was made in December 1952. Manoochehrian could easily have otherwise disposed of the sum of $2,857.14 received from Malakoff on January 2, 1953 and in the light of all the evidence it seems reasonable to believe that Malakoff would not have indicated on the memorandum that he had paid Manoochehrian $2,857.14 in January unless he had actually done so.

[fol. 229] Manoochehrian testified that he entered into an arrangement to sell his stock to Jerome Fried, his brother's brother-in-law, for $12,500. He said that this arrangement was later changed so that Manoochehrian remained half owner of the twenty shares and the purchase price was reduced from $12,500 to $12,000. The sale of Manoochehrian's stock to Fried is, however, irrelevant in connection with the issue as to the validity of the stock and the status of the holders thereof.

Manoochehrian advanced the sum of $20,000 to Wales on a note endorsed by Malakoff. Three payments of $2,857.14 were made to him in reduction of this loan. He also received one interest check for $33.33 and another for $177.78. The total amount therefore returned to Manoochehrian was $8,782.53. Therefore the sum of $11,217.47 constitutes the net fair value of Eskandar Manoochehrian's investment in Nazareth.

73. Claim No. 38 for 6 shares of Nazareth stock was filed by *Ann Rosen*. This claim is based upon Certificate No. 27 dated the 2nd day of February 1953. This claim is

stated to be in the sum of $6,000 or in the alternative for 6 shares of the debtor's stock. The stated consideration in said claim is $6,000 paid to Malakoff for 6 shares of the debtor's stock at the rate of $1,000 per share, which consideration was paid in or about the month of December 1951 and January and March 1952. No attorney in fact is designated in the proof of claim.

[fol. 230] Objections to the allowance of Stock Claim No. 38 of Ann Rosen were made by the debtor on the ground that Malakoff had no title to the stock that was transferred to claimant and on the further ground that no consideration passed to the debtor. As a counterclaim, the debtor prayed that it recover the sum of $6,000, the unpaid subscription price, in the event the stock claim of Ann Rosen was sustained. A reply to the counterclaim was filed by claimant and in behalf of Robert H. Davidson, Assignee, by Melvin L. Robbins, Esq. Notice of a hearing on the said objections was given by the Examiner to claimant, Melvin L. Robbins, Esq. and Alex L. Rosen, Esq., attorney for the debtor.

Ann Rosen testified that she first met Malakoff in the latter part of 1951 or the early part of 1952. She was introduced to him by Mrs. Rhea Hirschkorn who had told her that she knew of a man (Malakoff) who had an investment whereby she could get 20% on her money. Thereafter Mrs. Rosen gave Mrs. Hirschkorn a check with which to purchase six shares of Nazareth stock in piecemeal fashion. Mrs. Hirschkorn took the check to Malakoff and brought back a receipt. Mrs. Rosen did not speak to Malakoff personally or by telephone before she gave Mrs. Hirschkorn the check.

Claimant produced a check for $3,500 payable to Malakoff dated December 20, 1951 and drawn upon the Corn Exchange Bank Trust Company. She stated that this was the check that was sent to Malakoff through Mrs. Hirschkorn. This check was endorsed John Malakoff, John Malakoff Agt. [fol. 231] and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Mrs. Rosen received a receipt for $3,500 signed by John Malakoff dated December 20. This receipt was the usual long form receipt and indicated that she had a 3.5 200ths interest in the

market. After John Malakoff's signature he wrote "There are a total of 200 shares issued".

After investing $3,500 in Nazareth stock, claimant received a dividend check for $19.44 purportedly covering dividends for the month of December 1951. This check was signed by John Malakoff Agent, was dated January 2, 1952 and was drawn upon the Corn Exchange Bank Trust Company. Over the endorsement of Ann Rosen appeared the legend "Re-Nazareth." This check actually represented a dividend on Ann Rosen's investment of $3,500 for one-third of the month of December.

Some time after receiving the first dividend check, Mrs. Rosen gave Mrs. Hirschkorn another check for investment in Nazareth stock. Actually this was at or about the time of the receipt of the dividend check for $19.44 because Ann Rosen issued a check for $1500 to Malakoff dated January 4, 1952 drawn upon the Corn Exchange Bank Trust Company. This check was endorsed John Malakoff, John Malakoff Agt. and was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Mrs. Rosen received a receipt for this $1500 signed by John Malakoff and dated January 7, 1952. This was the usual long form receipt. Although this receipt simply acknowledged the receipt of $1500 after Malakoff's signature at the bottom thereof he wrote the following: "Up to date you now have 5/200th of Nazareth."

[fol. 232] Claimant then testified that after getting the receipt for the $1500, she went to Malakoff's office with Mrs. Hirschkorn when she was introduced to Malakoff for the first time. On meeting Malakoff he told her that she was lucky to be able to buy shares in the market and that soon the shares would sell for $1500. He also told her that if she intended to buy any more shares, she should do so in a hurry. Mrs. Rosen told Malakoff that she had originally intended to take six shares and she would give him a check for the balance of $1,000 as soon as she was able to do so.

A dividend check for $83.33 was received by Mrs. Rosen around the first of February 1952. This check represented the monthly return on an investment of $5,000 at 20% per annum.

Claimant also received dividend checks of John Malakoff, Special for $83.33 in March and April 1952. These checks were drawn upon the Corn Exchange Bank Trust Company.

According to claimant, some time in March 1952 she gave Malakoff another check for investment in Nazareth. This check was for $1,000 and was handed to Malakoff personally in his office. The check was dated March 5, 1952, was drawn upon the Corn Exchange Bank Trust Company and was endorsed John Malakoff, John Malakoff Agt. It was deposited in the Malakoff Agent account in the Corn Exchange Bank Trust Company. Claimant did not receive a receipt at the time this $1,000 check was given to Malakoff but later received the usual form receipt dated April 20, 1952. Although this receipt covered $1,000, at the bottom thereof after Malakoff's signature he wrote the following: "P.S. You now are in possession of 6/200th or an investment of $6,000.00".

[fol. 233] Commencing with May 1952 and continuing through January 1953 claimant each month received a check for $100 of John Malakoff, Special. All of these checks except the June check were produced and marked in evidence. There is no doubt that claimant received a dividend check for June. Each check represented the monthly payment due on an investment of $6,000 yielding a return of 20% per annum. Claimant also received a check for $100 from Malakoff in April 1953 and a check for the same amount in May 1953. Both of these checks were drawn upon the Manufacturers Trust Company. In addition, claimant received a check for $100 in February 1953 and a similar check in March 1953 of Nazareth drawn upon the Second National Bank of Nazareth, Pennsylvania. Thus claimant in all received a total of $1,569.43 in so-called dividends.

Some time in 1953, Mrs. Rosen received Stock Certificate No. 27 from Malakoff. This stock certificate is regular on its face. There is nothing on the stub for this certificate that indicates that it was issued subject to any qualifications, restrictions or conditions.

Mrs. Rosen had other transactions with Malakoff, apart from the Nazareth transaction. She made investments in

the Hotel Wales and Hotel Margaret through Malakoff and a number of checks passed from claimant to Malakoff and from Wales Properties Inc. and Malakoff to claimant. Claimant also received a number of promissory notes from [fol. 234] John Malakoff and Ambassador Estates, Inc. which apparently were never paid. These transactions had no direct connection with Nazareth so far as the record discloses. By letter dated April 29, 1952, John Malakoff acknowledged that he had received $18,000 from Ann Rosen which made her a one-fourth owner of Hotel Wales leases. In this letter he stated that she would receive 20% on her investment in monthly installments of $300 guaranteed by Malakoff.

In a letter dated December 15, 1952 signed by Malakoff, he acknowledged her 25% interest in the issued stock of the corporation operating the Wales Hotel for which she had paid him $18,000. He also stated that he was holding for her account two shares of stock in the corporation operating the Hotel Margaret, for which he had received $2,000, and he acknowledged an additional indebtedness to her of $22,000 for moneys advanced from time to time.

In the said letter of December 15, 1952, Malakoff acknowledged two deposits against certain specified deals, one of $1250 and the other of $500, and he stated that he was holding for the account of claimant six shares in the operating company of Nazareth Farmers Market for which he had received the sum of $6,000. In a letter dated June 1, 1953 sent to claimant by Malakoff, which he asked claimant to sign and return, Malakoff, among other things, stated that claimant then had six shares of Nazareth, six shares in Hotel Wales, $10,000 cash (note); $8,000 notes of $500 each, and that all other items had been paid. Mrs. Rosen did not sign this receipt and return it to Malakoff as requested.

[fol. 235] Claimant's endorsement appears on check for $1,000 of Nazareth dated February 19, 1953 and drawn on the Second National Bank. Mrs. Rosen testified that she cashed this check for Malakoff. Claimant's endorsement also appears on a check of Nazareth for $1,000 dated February 11, 1953 drawn upon the same bank. According to Mrs. Rosen, Malakoff needed money and she endorsed

these checks so he would be able to cash them at her branch of the Corn Exchange Bank Trust Company.

Mrs. Rosen said that she did not make loans to Malakoff although she would cash checks for him and enter into exchange transactions with him. At times he would give her post-dated checks of Nazareth. When she was examined before trial, Mrs. Rosen testified that she loaned money to Malakoff which he returned in some instances and in other instances did not. She said that she loaned him money also in connection with Nazareth. She also testified that Malakoff would give her a post-dated check and when the check was put through for collection, it would come back for insufficient funds.

Mrs. Rosen produced debit memos from the Corn Exchange Bank Trust Company reflecting the charging to her account of three protested checks of Nazareth drawn on the Second National Bank of Nazareth. One debit memo was dated March 25, 1953 in the amount of $914.38 and covered a check of $912.50 plus fees of $1.88. A second memo was likewise dated March 25, 1953 and covered a check for $1,898.50 plus fees of $1.88 making a total of $1900.38. A third memo was for $2002.13. This memo was dated March 4, 1953 and covered a check for $2,000 plus [fol. 236] fees of $1.88 and a charge of 25¢. Mrs. Rosen further testified that when Malakoff needed money with which to pay dividends to the Nazareth investors he would give post-dated checks to her. She would then lend him the money which he would deposit in his account. This money was obtained by her through the cashing of U.S. Government bonds worth $15,000 or $20,000.

A check for $3,200 of Nazareth drawn on the Nazareth National Bank dated January 20, 1953 was made payable to Ann Rosen and was signed by Jerome Fried. This check was endorsed by Ann Rosen and seems to have been deposited in her account in the Corn Exchange Bank Trust Company on January 20, 1953. Claimant did not remember the circumstances under which she received this check for $3,200. It appears, however, that on January 20, 1953, Ann Rosen drew a check for $3,200 payable to herself and this check was charged to her account in the Corn Exchange Bank Trust Company on January 21, 1953. Claimant re-

membered that the $3,200 debtor's check represented an exchange item. This testimony is supported by the transcript of the Nazareth bank account in the Nazareth National Bank and Trust Company. That transcript reflects a deposit of $3,200 on January 23, 1953 and a withdrawal on the same date.

Claimant also endorsed a Nazareth check for $4,200 dated December 30, 1952 drawn on the Nazareth Bank and Trust Company and payable to the order of "Special". This check was deposited by claimant in her account in the Corn Exchange Bank Trust Company on December 30, 1952. Claimant then drew a check for $4,200 on her account [fol. 237] in the Corn Exchange Bank Trust Company on the same day. This check was made payable to herself and she endorsed the same. On December 29, 1952 a deposit of $4,200 was made in the Nazareth bank account and a charge of $4,200 was not made against the account until January 6, 1953. It is thus clear that so far as Ann Rosen was concerned, the check for $4,200 of Nazareth was an exchange item, and nothing more.

The dealings between Malakoff and Ann Rosen were complex. It is impossible to relate each check payable to Ann Rosen or endorsed by her to a check of Ann Rosen payable to Malakoff or for his account. On the entire record, however, it is not possible to make a finding that Ann Rosen received from Malakoff more than she gave him, much less a finding that Ann Rosen received any money from Nazareth to which she was not entitled. The testimony of Ann Rosen is contradictory. Nevertheless, she engaged in so many transactions with Malakoff that her contradictions at least can be understood. There is a failure of adequate evidence of usury in the transactions of Ann Rosen with Malakoff, even assuming that usury would be relevant to the issue as to the right of Ann Rosen or her successor in interest to stock in Nazareth.

That Ann Rosen invested $6,000 in Nazareth is perfectly clear. That the sum of $1,569.43 was returned to her in so-called dividends is equally clear. The evidence is far from preponderating that any additional moneys were returned to Ann Rosen by Malakoff. On the contrary, all of the credible evidence indicates that Ann Rosen still re-

tained her investment in Nazareth at the time Malakoff sur- [fol. 238] rendered control of the business to present management. Accordingly, the sum of $4,430.57 constitutes the net fair value of the investment of Ann Rosen in Nazareth.

There is testimony that Ann Rosen assigned her claim to Robert H. Davidson for $5,500. Checks covering the consideration for such assignment were offered and received in evidence. The assignment of the claim, however, is irrelevant to the question as to the right of Ann Rosen or her assignee to be classified as stockholders of Nazareth and if so, to what extent.

74. Claim No. 15 for 35 shares of Nazareth stock was filed by *Frederick Katzenell*. This claim is based upon Certificates No. 51, 52, 53, 54, 55, 56 and 57 for 5 shares each, all dated the 2nd day of March 1953. No consideration for the said stock is stated in the proof of claim. Katzenell makes claim for the value of said stock. No attorney in fact is designated in the proof of claim.

Objections to the allowance of Katzenell's Stock Claim No. 15 were filed by the debtor and by the Margolis group. The debtor's objections are as follows: (1) that Malakoff had no title to the stock that was issued to claimant, (2) that no consideration passed to Nazareth in which case claimant would be indebted to the debtor in the sum of $35,000, the unpaid subscription price, (3) that if claimant paid $2,000 to Malakoff as President of the debtor as and for his subscription to 35 shares of capital stock, claimant [fol. 239] is indebted to Nazareth for the balance of the purchase price, to wit, $33,000, (4) that Katzenell is not the owner of the stock certificates for which he filed claim and that the stock was given to Katzenell as security for a debt owed personally by Malakoff to Katzenell. The Margolis objections charge that at no time did Katzenell become the owner of the 35 shares, that the delivery of such shares by Malakoff to Katzenell was without consideration to either Nazareth or Malakoff and that the 35 shares of stock do not constitute an obligation of Nazareth, are null and void, and should be delivered up and cancelled. These objections also allege that the stock acquired by Katzenell was in excess of the authorized issue of 200 shares; that the

consideration for the 35 shares was actually $25,200 and not $35,000 as agreed upon, so that 10 shares of stock should be cancelled in any event; and that the objections interposed by the debtor to the allowance of the Margolis claims should be deemed to have been interposed to the allowance of the Katzenell claim. Katzenell filed an answer to the objections of the Margolis group and Katzenell by Melvin L. Robbins, Esq. filed a reply to the counterclaims asserted by the debtor in its objections. Notice of a hearing on the said objections was given by the Examiner to Katzenell, and Messrs. Gothelf, Robbins, Margolis and Rosen.

Katzenell testified that he was introduced to Malakoff by Seymour Forman in the beginning of 1950. On September 4, 1951, according to Katzenell's first testimony, Malakoff showed him financial statements on the Farmers Market which reflected an income of over $70,000, expenses [fol. 240] about $40,000 with a net profit of about $30,000. Malakoff told Katzenell that a quarter of the market could be purchased by Katzenell and that he was going to issue shares at a later time, about 200, of which Katzenell would have 50.

Katzenell was also told that Malakoff had purchased the market from Ed. Malakoff and that the first portion thereof was on the basis of $64,000 representing a quarter interest.

On September 4, 1951, so Katzenell testified, Malakoff in his presence wrote out a receipt to Frederick Katzenell and Margareth Katzenell which was signed by Malakoff and read as follows: "I hereby confirm receipted amount totalling Thirty Thousand ($30000.00) for 1/4 share of Farmers Market at Nazareth (50 shares of total 200 issued). This letter receipt was produced and marked in evidence.

Katzenell said that he gave $2,000 to Malakoff at the time the receipt was made out and that the balance represented $28,000 which was then owing by Malakoff to Katzenell. Katzenell produced a check for $2,000 signed by him drawn on the National City Bank of New York dated September 4, 1951 made payable to the order of John Malakoff Agt. This check was endorsed John Malakoff, John Malakoff Agt. and was deposited in the Malakoff Agent account in the

Corn Exchange Bank Trust Company. Over the endorsement of John Malakoff appears the following legend: "Re Nazareth total 30000."

Later Katzenell testified that in April or May 1951 he gave Malakoff a check for $2,500 for the purchase of a one-fourth interest in one-fourth of a contract to acquire the Nazareth market. He said that subsequently and in [fol. 241] September 1951 he purchased the $30,000 interest or 50 shares in the market. He also testified that he arrived at the $30,000 figure as the amount owing to him by Malakoff by adding all the moneys he had advanced to Malakoff up to September 1951 and crediting Malakoff with any profit that had been returned to him and then subtracting all the moneys representing return of capital. This computation left a balance of about $28,000 which, together with his check for $2,000, made up the total of $30,000.

Claimant further testified that the seven stock certificates, numbered 51 to 57 inclusive, were delivered to him on March 2, 1953 in Malakoff's office. These stock certificates are regular on their faces and each one is in the name of Frederick Katzenell. The stubs for these certificates, however, show that they were issued to John Malakoff. At the top of each stub appears the legend "security" handwritten in ink and under Malakoff's name appears the legend "security FK".

Katzenell testified that commencing in November or December 1951 he received by way of dividends on his Nazareth investment $500 per month. These dividends were given to him by Malakoff by check or in cash. His best recollection seems to be that the first dividend payment of $500 was made in December 1951 but this cannot be correct. He must have received a dividend payment of $500 on or about November 1, 1951, if not on October 1, 1951. If, as he claims, his deal with Malakoff was made on September 4, 1951 then under Malakoff's normal practice, Malakoff would have commenced paying dividends on or about October 1, 1951. In any case, it is reasonably cer- [fol. 242] tain that Katzenell received a $500 dividend payment in November 1951. The dividends from Nazareth, so Katzenell testified, continued until May 1953. During the latter period, however, he said that he received the reduced

amount of $350. He claims that he did not make a record of the dividends he received in cash from Malakoff in regard to the Nazareth Market.

The $500 dividend payments on Nazareth from Malakoff continued until September 1952. On September 2, 1952, Malakoff gave Katzenell a check for $400 and later that month cash in the amount of $100. Katzenell testified that in September 1952, he went to Malakoff's office and was given ten notes for $3600 each, so he claims, as security for his shares. Despite the fact that the notes aggregated $36,000 Katzenell said that his interest in Nazareth at that time was in the dollar value of $30,000. When he received these notes he reached an understanding with Malakoff that as each note was paid Katzenell would have 5 shares less in Nazareth. Malakoff, so Katzenell testified, paid three of the ten notes or a total of $10,800.

These notes, which were dated September 9, 1952, became due on October, November and December 9, 1952. The reason each note was $3600 instead of $3,000 was to compensate Katzenell for his loss of dividends on his shares of stock in Nazareth. His claim is that he received no dividends in October, November or December 1952. Katzenell discounted these notes with Simon Rosenkranz. Prior to the maturity date of the third note, that payable on December 9, 1952, Malakoff told Katzenell that he did not have enough money to pay that note. Katzenell gave Mala- [fol. 243] koff $1500 of his own money to add to $2,000 that Malakoff had in order that the note should be paid when presented by Mr. Rosenkranz. Malakoff returned $200 of the $1500 advance to Katzenell in January 1953, so Katzenell said but the actual amount must have been $250 as evidenced by check of John Malakoff, Special dated January 24, 1953 in that amount drawn upon the Corn Exchange Bank Trust Company. Katzenell's deposit indicates that this $250 payment applied against the $1500 loan.

Some time during 1952, Malakoff told Katzenell that he would not be able to pay the other seven notes. He said that starting with January, he would pay Katzenell dividends of $350 per month on the 35 shares of Nazareth stock still held by Katzenell. Katzenell produced portions

of six unpaid promissory notes of John Malakoff, Agent dated September 9, 1952, each in the sum of $3600. He did not produce the whole nor any part of the $3600 note which became due on January 9, 1953. Despite his testimony that he assisted Malakoff in meeting the December 9, 1952 note by advances to Malakoff of $1500 at or about that time, it is fair to infer from the testimony that the $1500 advance was made by Katzenell to Malakoff in connection with the note which became due on January 9, 1953.

The transcript of the account of Katzenell with the National City Bank of New York reflects two credits of $3600 each and one debit of that amount during December 1952. This transcript does not reflect a deposit of $1500 by Katzenell in his National City Bank account in December 1952. [fol. 244] Thus this account was enriched to the extent of $3600 during December 1952 and the conclusion is inevitable that this resulted from a payment made to Katzenell indirectly by Malakoff through Rosenkranz. Katzenell made a deposit of $3600 in the National City Bank which the bank acknowledged on December 15, 1952. This deposit represented a check of Simon Rosenkranz for $3600 dated December 13, 1952 drawn upon the Chase National Bank. On December 17, 1952, the sum of $3600 was debited to Katzenell's account in the National City Bank because the Rosenkranz check had been returned for insufficient funds. On the same date the National City Bank notified Katzenell that the $3600 had been recredited to his account presumably because Rosenkranz's check had been made good or had been honored by the Chase National Bank.

Katzenell received a note for $1500 of John Malakoff Agent dated January 9, 1953 and payable on February 2, 1953. This is consistent with Katzenell having given $1500 to Malakoff on or about that date and not prior thereto. It is also consistent with Katzenell having advanced this sum to Malakoff in connection with the $3600 note due on January 9, 1953. There would have been no reason for Katzenell to advance $1500 to Malakoff on or about January 9, 1953 to assist Malakoff to pay a $3600 note which it appears had already been paid in December 1952. Furthermore, it is significant that Katzenell did not or could not produce the $3600 note which became due on January 9,

1953. If the note had been paid, as appears to be the fact, Katzenell could not have produced the note. Katzenell did [fol. 245] lend Malakoff $1500 to enable him to meet the January 9, 1953 note. Of this amount, $250 was returned, according to Katzenell, and $1250 was never returned. Katzenell must be debited with $2350 in connection with his Nazareth investment, representing the difference between the face amount of the note and the unpaid balance to Katzenell on his advance of $1500 to Malakoff in connection therewith.

Presumably Katzenell received a $350 dividend check in January 1953. A check for $350 of Nazareth drawn on the Second National Bank of Nazareth was given to Katzenell for the February dividend but this check was returned for insufficient funds. Malakoff gave Katzenell another check and cash to make good this check.

On or about March 12, 1953 Katzenell received a check of John Malakoff, Special for $250 drawn on the Corn Exchange Bank Trust Company. This check was deposited by Katzenell in his bank account in the National City Bank with the notation thereon that it represented a payment on account of the March dividend on Nazareth. Katzenell also received $300 as Nazareth dividends on March 20, 1953. Katzenell received $350 in Nazareth dividends in April 1953. On May 25, 1953 Katzenell deposited the sum of $150 in his bank account and on his duplicate deposit ticket stated that this represented the balance due on the May dividends from Nazareth. He also testified that he had previously received $200 for dividends in that month. According to Katzenell, he received no dividends after May 1953. Katzenell said that he returned the seven unpaid Malakoff notes to Malakoff in March 1953 when he received the Nazareth stock certificates.

[fol. 246] On the basis of Katzenell's testimony it is fair to conclude that commencing with November 1951 and continuing through September 1952, Katzenell received $500 each month from Malakoff as dividends on his Nazareth investment. It is also fair to say that commencing in January 1953 and continuing through May 1953 Katzenell each month received $350 in dividends from Malakoff. Thus Katzenell received $1,000 in dividends in 1951, $4500 in dividends in 1952 (excluding the additional payments of $600 each in

the October, November and December 1952 notes for $3600 each), and $1750 in 1953. His total dividends therefor were $7250.

Katzenell's 1951 income tax return does not reflect the receipt of any dividends although these dividends may have been included under other items or charged off against expenses. His 1952 income tax return reflects the receipt of dividends from Nazareth in the amount of $4950. Katzenell's 1953 income tax return lists $1300 as having been received during that year. The total received by Katzenell in 1952 or 1953, according to his income tax returns, was therefore $6250. On the basis of his testimony, during 1952 and 1953, Katzenell received a total of $6250.

In October 1951, Katzenell made a loan to Malakoff in the amount of $9200. This loan was represented by two checks, one dated October 11, 1951 for $5,000 of Katzenell drawn on the National City Bank of New York and the other for $4200 dated October 24, 1951 made by Katzenell and drawn on the National City Bank of New York. Both of these checks were endorsed John Malakoff, John Malakoff, Agent and were deposited in the Malakoff Agent account in [fol. 247] the Corn Exchange Bank Trust Company. Over the endorsement of John Malakoff on the October 11, 1951 check appears the legend "Re Nazareth". Malakoff gave Katzenell post-dated checks over a period of two or three months of $1,000 each (except that the last check was for $200) to repay the $9200 loan. All of these post-dated checks were paid.

Katzenell had numerous other transactions with Malakoff. These transactions started on or about the 2nd day of February 1950 and extended into 1952. The first transaction involved an advance of $1,000 made by Katzenell to Malakoff for investment in a Baltimore deal. Thereafter and for a good period of time, the dealings between Katzenell and Malakoff became very intense and complex. Many checks of John Malakoff were issued to or were endorsed by Katzenell. In addition, a good number of promissory notes of Malakoff were issued to the order of Katzenell and presumably were paid. On the other hand, a large number of Katzenell checks were issued to Malakoff or to or for his account or at his request in connection with the deals.

No useful purpose would be served by attempting to connect each check issued by Malakoff to or for the account of Katzenell with a check or checks issued by Katzenell to or for the account of Malakoff. Katzenell attempted such a reconciliation and to a substantial degree succeeded in doing so. In the last analysis, however, proof of an original [fol. 248] investment of $30,000 by Katzenell in Nazareth through Malakoff must rest upon testimony as to the aggregate of sums advanced by Katzenell to Malakoff or for his account plus profits thereon up to September 1954 less returns of capital and profits by Malakoff to Katzenell prior to that date. There is, of course, additional evidence that Katzenell did in fact have $30,000 invested in Nazareth from the fact of so-called dividend payments on that amount by Malakoff to Katzenell monthly commencing in November 1951 and continuing through September 1952.

The debtor points out contradictions in the testimony of Katzenell. For example, at one place in the record it appears that Katzenell testified that the $30,000 paid by him to Malakoff represented a balance due to him from Malakoff on September 4, 1951, whereas at another place in the record it appears that Katzenell paid the $30,000 to Malakoff in a lump sum. The debtor also calls attention to various erasures and changes which appear to have been made on checks given to Malakoff by Katzenell. The debtor also contends that the testimony of Katzenell is replete with falsehood and with fabrications. In addition, the debtor charges Katzenell with having participated in usurious transactions with Malakoff.

There is no doubt about the fact that Katzenell's testimony is replete with contradictions. The preponderance of the evidence, however, supports a finding that Katzenell did in fact invest $30,000 in Nazareth through Malakoff. No part of this $30,000 was received by Nazareth itself directly, or indirectly so far as the record here is concerned. [fol. 249] But it is clear that Malakoff owed Katzenell $30,000 on September 4, 1951 as a result of accumulated transactions or otherwise. Malakoff would not have paid Katzenell interest or dividends on a Nazareth investment from November 1951 through September 1952 if that money had not been invested by Katzenell in Nazareth. Katzenell

testified that he received the dividend payments of $500 monthly and his income tax returns reflect the receipt of dividends from Nazareth in 1952 and 1953.

Katzenell gave Malakoff $30,000 for investment in Nazareth. Whether the consideration was a past or a present one is unimportant. It also does not matter whether the Nazareth stock was actually given to Katzenell by Malakoff as security in the first instance. On September 4, 1951, Malakoff owed Katzenell $30,000 and agreed that he should have shares of stock in Nazareth either as security for the indebtedness or as the outright owner of such stock. Four notes for $3600 each of Malakoff's evidencing the $30,000 debt and including dividends (or interest) were paid by Malakoff. That totals $14,400. Katzenell is entitled to a credit of $1250 against this total representing the unpaid balance of the $1500 advance. That increases the debt to him from Malakoff to $16,850. Katzenell received eleven dividend payments of $500 each and five dividend payments of $350 each. These total $7250. Subtracting these so-called dividend payments, which in fact represented a return of capital, from the balance of $16,850 leaves a balance of $9,600. This sum of $9,600 constitutes the net fair value of the investment of Frederick Katzenell in Nazareth.

[fol. 250] During the course of this proceeding, Katzenell transferred all of his interest in and to the Nazareth stock in his name to Robert H. Davidson, subject, however, to a reservation of an interest in such stock under certain contingencies. The transfer of this stock is irrelevant to the question as to the propriety of the issuance of the stock in the first instance and the extent to which the holder of such stock should be permitted to participate in Nazareth.

The Issuance of Certificates, the Holding of Directors' and Stockholders' Meetings and Other Corporate Formalities.

75. The issuance of the first twenty shares of stock to Messrs. Zoloth and Soble and the sale of those shares, represented by certificates numbered 1 and 2, to Malakoff, are described earlier in this Report. On June 17, 1953 Malakoff endorsed over to the debtor itself the said stock certificates numbered 1 and 2. At the time of this endorse-

ment, Malakoff was hopelessly insolvent and the persons who were then acting as officers of the debtor were well aware of that fact.

76. No other certificates of stock were executed or delivered until February 1953. On or about February 2, 1953, Malakoff began issuing certificates to those who had made investments in Nazareth up to that time. A total of thirty-two certificates, aggregating one hundred forty-eight shares were issued, dated February 2, 1953. Eight more certificates, aggregating thirty-four shares, were issued, dated March 2, 1953. Ten other certificates aggregating eighty-two shares, bearing various dates from March 12, 1953 to April 28, 1953, were thereafter issued.

[fol. 251] 77. Almost all of the certificates, as heretofore stated, were regular on their face and were signed by Malakoff as President and Jerome Fried as Secretary of the company. Fried affixed his signature to the certificates in blank, acting at the direction of Malakoff. Malakoff alone completed the certificates and delivered them. There appears to be no relationship between the order in which the certificates were made out and delivered or the certificate numbers and the order in which the persons receiving them made their investment, except as to a very few who invested in Nazareth stock at the very end of Malakoff's control of that corporation. As indicated, most of the investors received from Malakoff a letter form of receipt which provided as follows:

> "You understand, of course, that all of the authorized stock of The Nazareth Farmers and Auction Market Inc. [sic] which owns the Market has been issued to me. Under our arrangements, I am obliged to you for a proportionate share of my earnings, dividends, liquidating or otherwise and profits from the Market as I receive them. For your information, I may say that the dividends have been declared at the rate of Twenty Per cent. (20%) per annum, payable monthly. It is expected that a dividend at the same rate will be paid on the first of each month. Additional dividends will be declared as income warrants.

"In the course of my management of the Market, I may cause to be issued to you ..... shares of my present stockholdings. On the other hand, I may cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your ..... shares will be applied as your contribution with a corresponding proportionate interest. At all events, the method of operation is to remain solely in my hands • • • ."

[fol. 252] 78. Some of the investors, as also indicated above, received a different letter, handwritten or typed, which stated the number of shares issued to the investor, or the interest of the investor in Nazareth in terms of a fraction, the denominator of which was 200. Some of the letters stated that the monies received were to be held by Malakoff in "escrow", but the terms of the said escrow were not defined.

79. No share or stock transfer ledger or book was kept by Nazareth. The only record kept concerning the identity of stockholders and the shares held by them consisted of the entries on the stubs of the stock certificates.

80. Until May 1953 no meetings of stockholders were held. The minute book of Nazareth was not regularly kept. The first minutes of August 9, 1951 have been described earlier in this Report. In or about May 1953 a meeting was held in Malakoff's office. Present were Messrs. Katzenell and his attorney, Gothelf, claimant Kanter and his attorney, Harbater, claimant Hull, claimant Margolis and Malakoff. Katzenell had retained Gothelf to investigate Malakoff's business dealings. Gothelf had heard talk of over-subscriptions and other financial difficulties.

81. At the said meeting in Malakoff's office, it was ascertained that over three hundred shares of stock of the debtor had been issued. Claimant Kanter's attorney, Harbater, counted three hundred sixty-five shares. The corporate minute book was examined. It contained no minutes after 1951. Malakoff was granted an extension of time to re-acquire some of the issued stock.

[fol. 253] 82. At another meeting, held about one week later, the minute book was examined again. It contained minutes which had not appeared in the book at the earlier meeting. At this second meeting, Kanter's attorney, Harbater, counted two hundred ninety-three shares of stock outstanding.

83. Claimant Hull was evidently a director of the debtor from October 17, 1951 to June 4, 1953. In or about April or May of 1953, Malakoff informed Hull that there had been an over-subscription and over-issuance of the debtor's stock. At a meeting held on June 4, 1953, Hull resigned as director because he did not want to sign corporate minutes authorizing the issuance of two judgment notes for $5,000 each, payable to one Shongut, and another note for $3,600, payable to claimant Margolis. He did sign, as a director, certain minutes prepared subsequent to his resignation, where were predated.

84. Claimant Hull drafted minutes of a purported meeting, held to authorize the transfer of corporate stock at $75 per share to Malakoff. The said meeting, however, was never held. The said minutes were predated and purportedly reflected action taken at purported meetings, relating to the application of windstorm insurance proceeds to the issuance of one hundred eighty shares of the debtor's stock to Malakoff at $75 per share and to the judgment notes described above. The minutes were drawn between the middle and end of June 1953 and were signed by Hull and Fried.

85. At Gotheif's request, Harbater wrote a letter to the group of stockholders of the debtor requesting them to attend a meeting at Gothelf's office on May 22, 1953. Mala- [fol. 254] koff thereupon resigned as President of the debtor and Arnold Weinstein was elected President of Nazareth. Weinstein and claimants Margolis and Kanter were elected directors. On or about July 13, 1953, Alex Rosen, Esq., attorney for the debtor in the reorganization proceedings herein, was retained by the debtor. The institution of the present reorganization proceedings followed shortly thereafter.

The Payment of "Dividends" by Malakoff.

86. In connection with most of his sales of stock of Nazareth and of interests in the Nazareth venture, Malakoff represented to investors that their investments would yield 20% a year. The exact terms which he used, that is, whether he spoke of "dividends", "return", "net return", or some similar term, is not material. Whatever the specific term used by him, his representation to most of the investors was that they would earn 20% annually. He did pay a total of $36,268.02 to the claimants-stockholders.

87. The said payments cannot be terms "dividends" in the technical sense for a number of reasons hereafter stated in more detail. For the purposes of this Report, however, heretofore and hereafter they are referred to as "so-called dividends" or "dividends". Actually these dividends represented a return of capital.

88. The dividend payments by Malakoff commenced on September 1, 1951, when he started sending monthly checks to each investor who had theretofore made an investment in Nazareth through Malakoff. The amount of each monthly [fol. 255] check was one-twelfth of 20% of the investment. Except for the months of February and March 1953, practically all checks were drawn on one of three accounts of Malakoff, that of "John Malakoff", "John Malakoff, Agent", or "John Malakoff, Special". The monthly checks continued generally through May 1, 1953, although a few investors received dividends in June 1953. Most of the checks issued in February and March of 1953 were drawn on the debtor's account in the Second National Bank of Nazareth. The moneys deposited in this Nazareth bank account of the debtor were unrelated to its regular operations. In or about April, May and June of 1953 some of the dividend checks were dishonored by the drawee banks for insufficient funds. The dishonoring of these checks was one of the events which led to the meetings and the retention of and action by attorneys for several of the claimants, described above.

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89. The foregoing statement of facts and the findings and conclusions incorporated therein result from an analysis

by the Examiner of approximately 10,000 pages of testimony taken by this court on the objections of the debtor and the Margolis group to the allowance of the proofs of stock interest filed by the claimants-stockholders, and an analysis of the hundreds of documents which were marked as exhibits during the hearings on the objections. That statement of facts and the findings and conclusions incorporated therein accurately reflect, so far as the Examiner has been able to ascertain, the cause of the tangled and [fol. 256] confused history of the debtor. There is necessarily uncertainty in certain areas because of the death of Malakoff early in the course of the pending reorganization proceeding and the absence of any thorough examination of Malakoff on relevant matters while he was alive. Nevertheless, the facts are sufficient, in the opinion of the Examiner, to enable this court to resolve the question as to who are the stockholders of the debtor.

90. There are certain findings and conclusion of fact which the Examiner deems significant in determining the principles and rules of law which should be applied in the determination of the question as to who are the stockholders of the debtor corporation. Those findings and conclusions are beyond cavil and can be stated without qualification. They are as follows, with comments thereon where the Examiner deems such comments relevant or appropriate:

(1) Many of the claimants-stockholders engaged in other business transactions with Malakoff, both before and after their investments in Nazareth.

(2) Malakoff did not invest his own funds but obtained financing from others; he promoted and managed the transactions and took a percentage of the profit from each venture, as he determined it. Frequently he attempted to retain the principal amount put up by his investors for use in future ventures.

(3) Despite the number of shares promised by Malakoff to the investors in Nazareth, generally he promised and paid dividends at the rate of 20% per annum on the principal amount invested by each investor; his dividend payments were not related to the number of shares promised or

delivered to each investor. The amount of the dividend paid [fol. 257] by Malakoff to each stockholder and the time of payment thereof constitute a fairly accurate index of the amount of the investment of each such stockholder and the time or times of such investment.

(4) No dividends were declared at any time by the debtor, the Nazareth Fairgrounds & Farmers Market Inc.

(5) During the period commencing August 8, 1951 and ending June 30, 1952, Nazareth was in no position to pay dividends to its stockholders. In that period of time Nazareth sustained a net loss of $1,614.45. On June 30, 1952 on the basis of a capital investment of $1,500 there was a deficit in capital of $114.45. The book assets totalled $88,284.08 and the book liabilities amounted to $88,398.53. The principal assets on June 30, 1952, as reflected by the records, were as follows: Land $6,000; buildings less reserve $67,315.13 and improvements less reserve $11,606.26. The bank account showed a deficit of $371.40. The liabilities included loans payable to Malakoff of $68,092.92, first mortgage payable of $8500 and second mortgage payable of $8,000.

(6) During the period commencing July 1, 1952 and ending June 30, 1953 Nazareth was in no position to pay dividends to its stockholders. In that period the records reflected a net profit of $11,192.13 after the deduction of $11,811.78 representing insurance proceeds recoverable from losses applicable to expenditures incurred. The balance sheet reflected a bank deficit of $471.93 and total capital and surplus of $11,077.68. The insurance proceeds of $11,811.78 were carried as an account receivable from Malakoff, and this item was not deducted from loans payable to Malakoff of $68,442.92.

[fol. 258] (7) The dividends aggregating $36,268.02 paid to the stockholders, with the exception of some dividends paid to stockholders in February and March 1953, represented payments made by Malakoff from one of his personal bank accounts and did not come from Nazareth directly or indirectly. In February and March 1953, dividend checks were issued by Nazareth on the Second National

Bank of Nazareth, Pennsylvania. The deposits in and the disbursements from this bank account were unrelated to the regular operations of the corporation. The funds deposited were supplied by Malakoff.

(8) None of the payments made by any of the claimants-stockholders, representing investments in Nazareth, was made directly to the debtor. Almost all of the checks were drawn or endorsed over to Malakoff or Helen Bernstein. There is nothing in the record which establishes that any of these payments became an asset of Nazareth even indirectly.

(9) From the time of his first acquisition of his interest in Nazareth to the date of his resignation as an officer and director of and dissociation from the debtor, Malakoff, insofar as he and the investors and stockholders were concerned, disregarded the corporate entity and separate legal identity of the debtor corporation. He and all of the investors in Nazareth, the claimants stockholders herein, regarded Nazareth as a business venture, and ascribed little or no importance to the legal form which the venture took, or to the observance of the legal and other formalities and requisites of its corporate form.

[fol. 259] The Applicable Equitable and Legal Principles

91. One conclusion of fact and of law stands out above all others in the determination of who should be deemed to be the stockholders of the debtor and in what proportions—that not one of the thirty-six persons who have filed the proofs of stock interest which are the subject of this Report has a clear legal right to any of the shares which he or she claims. Whether Section 7 of Article XVI of the Pennsylvania Constitution, prohibiting the issuance of corporate stock without receipt by the corporation of valid consideration, is deemed to be or not to be self-executing, all of the issued shares of stock of the debtor herein are at least voidable.

92. The very objections by the debtor to the proofs of stock interest represent the debtor's exercise of its right

to void all of such shares. A typical objection of the debtor is that if a claimant contended that he subscribed to the capital stock of the debtor, that claimant did not pay a consideration to the debtor. Consequently the stock issued by the debtor to the claimant is either void or voidable. The factual objection that no consideration passed to the debtor must be sustained. That is true as to all stock claims. Consequently on the basis of the debtor's objections there would be no stockholders. The debtor's memorandum, however, takes an alternative position. The memorandum argues that Malakoff acquired an interest in Nazareth for the account of those who invested in Nazareth through him. Therefore, so the argument runs, an interest in Nazareth may be predicated only on the basis of a present [fol. 260] consideration given to Malakoff for the express purpose of acquiring an interest in Nazareth. This conclusion does not necessarily follow from the premise that Malakoff purchased an interest in Nazareth for the account of those who invested in Nazareth through him. Since Malakoff and not the debtor was the direct recipient of all consideration paid for all of the shares of stock issued to the claimants-stockholders, and no claimant has attempted to trace, from Malakoff to the debtor, the consideration he or she paid to Malakoff, none of the claimants-stockholders can prove that he acquired any of his shares in strict conformity with law.

93. As stated, the debtor itself and all of the claimants-stockholders recognize this fact. Correctly, they point out that escheat is neither required nor just, that some persons must be deemed to be validly stockholders of the debtor and some of the shares claimed deemed to have been validly issued, and that, therefore, equitable principles must govern in this Court of Bankruptcy in the making of such determination.

94. The difficulty and shortcoming in the position of each of the two principal contenders in the hearings before this court, the debtor itself and Davidson, is that each asks this court to do equity up to a certain point only. Each proclaims and asks that this court apply broad equitable principles, but at a certain point each retreats from the

very principles he invokes. Thus the debtor asks that all who gave Malakoff moneys for the purpose of investing in the debtor, regardless of what happened to the moneys and of when the payments were made and of when the certificates were issued, be deemed valid stockholders. The [fol. 261] debtor, however, returns to strict rules of law when it comes to those claimants-stockholders who received shares of stock in satisfaction of or as security for John Malakoff's prior personal obligations. With respect to this second class of claimants the debtor argues strict law —that where Malakoff had no title his transferee can secure no title, absent an estoppel against the debtor or the true owners. It is important to note that the administration of the debtor, that is its directors and officers, is at best a de facto one. The term "debtor" is misleading in the sense that those who make up the debtor cannot be known until the court has resolved the question of the ownership of the stock of the debtor.

95. Davidson divides the claimants-stockholders into four categories, according to the time or times when they made their investments:

(1) Investors prior to August 7, 1951, when Nazareth was incorporated;

(2) Investors after August 7, 1951 and prior to October 17, 1951, when Malakoff acquired legal title to the first twenty shares of the debtor's stock (then the entire outstanding legal issue);

(3) Investors after October 17, 1951 and prior to February 2, 1953, the earliest date of any issuance of stock and delivery of certificates to any of the claimants-stockholders; and

(4) Investors after February 2, 1953.

95. Davidson's position is that those claimants-stockholders in his first three classes who received from John Malakoff, for value to him, promises of shares in Nazareth, [fol. 262] should receive in Nazareth stock precisely what John Malakoff promised them, upon proof that Malakoff made such promises and that the claimants gave such value

therefor. This may be deemed to be, to the extent of the determination of who should be stockholders, if not to the extent of the determination of what proportions of stock they should have, an application of equitable principles. With respect to the claimants-stockholders in his class 4, Davidson adds to the requisites for stock ownership to be applied to those in the first three classes that of proof that the debtor is equitably estopped from the defense of lack of consideration for such stock. The added requisite is obviously inconsistent with broad equitable principles because its applicability hinges on a cut-off date, February 2, 1953, which was a purely arbitrary date fixed by Malakoff as the date when he first began issuing certificates to investors.

96. Both the debtor and Davidson depart from wholly equitable consideration in one further respect. Both take the position that over-issued stock is absolutely void and that those claimants-stockholders who subscribed for stock after the first 200 shares had been subscribed for may, in no event, be deemed to be stockholders of the debtor.

97. Who are the stockholders of the debtor is one question. What proportion of the stock each stockholder should be deemed to own is a second question. If equitable principles require the second question to be answered on the basis of the actual consideration paid rather than the circumstances, in the case of many investors purely fortuitous, of how many shares Malakoff promised each in- [fol. 263] vestor, the answer of Davidson to the second question represents a further departure from the equitable principles which he invokes.

98. As hereinbefore stated, this court is not confined to the positions and arguments of the conflicting parties. The Bankruptcy Act imposes upon the court the duty of affirmatively seeking and searching for a just, fair and legal determination of who are the debtor's stockholders, as well as of every other problem involved in formulating a fair, equitable and feasible plan of reorganization.

99. In the opinion of the Examiner, the debtor and Davidson are correct in urging that this court apply equitable

principles in the determination of who are the stockholders of the debtor and what proportions of its stock they hold. The Examiner, however, believes that they are incorrect in imposing the limitations and restrictions upon the application of equitable principles. The history of the organization and creation of the debtor and of the sale and issuance of the certificates of stock held by the claimants-stockholders, which must be described as confused, if not chaotic, not only permits but compels this court to apply the equitable principles which all of the parties before it urge upon it without the restrictions which Davidson and the debtor seek to impose.

The Equitable Principles to be Applied.

100. This court need go no further than the basic statement quoted above, from Pepper v. Litton, for two of the equitable principles to be applied:

[fol. 264] (1) "Substance will not give way to form."

(2) "Technical considerations will not prevent substantial justice from being done."

For the one further principle required it may adopt one of the simplest of the classical maxims of equity jurisprudence: "Equality is equity." See *Burchfield* v. *Bevans*, 242 F.2d 239 (10th Cir. 1957).

101. In the opinion of the Examiner, literal application of the three equitable principles stated above answers the basic question of who are the stockholders of the debtor and in what proportions, by solving each of the three problems subsumed by the one basic question. Those three problems may be stated as:

(1) whether the rights of the claimants-stockholders should be distinguished by reference to a classification such as that proposed by the debtor or by Davidson, or by any other classification;

(2) whether the number of shares awarded to each claimant deemed to be a valid stockholder is to be determined by reference to the amount of the considera-

tion he or she pays or by reference to the number of shares promised by Malakoff, as evidenced by the certificate or certificates each claimant holds;

(3) whether any of the shares of stock of the debtor should be deemed void and any of the claims of stock interest, accordingly, denied, because of over-issuance of shares.

[fol. 265]

Application of the Three Stated Equitable Principles.

102. The problem of classification of the claimants-stockholders is posed by the general requirement of law that a corporation receive "consideration" for stock applicable in Pennsylvania. Pa. Const. Art. XVI, Section 7. The classifications proposed by the debtor and by Davidson represent their answers to the problem of consideration. Applying the first stated principle of equity, that "substance will not give way to form", is not difficult. Unless some overriding rule of law limits what this court may deem to be "consideration", under this first equitable principle, the term must be construed broadly to mean something of value. Whether there was a thing of value and the measurement of that thing of value in dollars are matters of "substance". The precise form of the thing of value given by each claimant-stockholder and the manner in which it was paid are, clearly, matters of "form".

103. Stated otherwise, each claimant-stockholder seeks a determination by this court that he is owner of shares of substantial value. The "substance" of what he seeks, in the form of shares of stock of the debtor is the value that he claims he gave. If "substance" is not to give way to "form," each claimant who gave value should receive value in the form of shares of stock of the debtor.

104. Applying this test, the classification of claimants-stockholders proposed by the debtor must fail. To discharge antecedent indebtedness whether, by application of collateral held as security after extending some period of time [fol. 266] to the debtor (Malakoff) to otherwise discharge the indebtedness, or by accepting a present transfer of

property to discharge the indebtedness without extending to the debtor (Malakoff) a period of time to otherwise discharge the indebtedness, is to give something of value.

105. Davidson's basic classification, based upon time, similarly falls. To ground the rights of the claimants-stockholders on the fortuitous circumstances of whether they made their investments before or after the date when Malakoff arbitrarily chose to commence the issuance of certificates, is to throw aside considerations of "substance" and to render "form" controlling. Davidson's subordinate classification of his fourth class of claimants-stockholders, similar to the classification by the debtor of all claimants-stockholders is invalid for the reasons applicable to the Debtor's classification.

106. Applying the second stated principle of equity to the problem of classification, the principle that "technical considerations will not prevent substantial justice from being done," dictates the same determination reached by applying the first equitable principle. However abstract and indefinite the term "justice" may be, in the proceedings herein it is certainly just that all who paid Malakoff in the belief that they were investing in the debtor or the business of Nazareth, regardless of when they made such payments and in what form, should be treated the same. It would certainly seem unjust to differentiate between such persons on the basis of fortuitous chronology, or on the basis of the form as distinguished from the value of the consideration given for investments in Nazareth.

[fol. 267] 107. The term "technical considerations" is perhaps almost as vague and abstract as the word "justice", and the limits of its coverage almost as difficult to draw as are the definition and coverage of the word "justice". It, nevertheless, does seem correct to term the considerations urged by Davidson and the debtor in support of their respective classification schemes to be "technical".

108. The application of the third equitable principle stated above, the maxim,—"Equality if equity", requires no extended discussion. The directness of its application is almost mathematical. If equality is equity and if this

court is to do equity, the rights of all claimants must be granted equal protection. "Equal protection" in this context, can be assigned the same meaning assigned to it in its constitutional context, the absence of any scheme of classification not related to the purpose served by the rule of law under which the classification is made. See, *Cunningham* v. *U.S.*, 256 F.2d 467 (5th Cir. 1958).

109. The second problem subsumed by the basic question of who should be the stockholders and in what proportions, is that of choosing the basis for the determination of the numbers of shares to be awarded each claimant deemed to be a valid stockholder. The evidence narrows the choice to two bases:

(1) The basis of the amount, in money, or money's worth, of the investment;

(2) The basis of the number of shares promised by Malakoff.

[fol. 268] 110. Applying the first stated principle of equity, that substance should not give way to form, what is to be deemed substance and what is be deemed form? The answer is clear from the evidence summarized above. Malakoff sold investments in Nazareth, not shares of stock per se. He promised an annual return of 20% on the number of dollars invested. He paid "dividends" on that number of dollars invested by each claimant, not on the number of shares held by each claimant. In a number of cases the number of shares granted to investors were fortuitous. In several cases it was changed by renegotiation. Under these circumstances "substance" must be deemed to mean the number of dollars invested by each claimant, and "form" must be deemed to mean the number of shares set forth on the certificate or certificates held by each claimant.

111. Equally clear is the answer to the second question under the second stated principle of equity. It would be substantially unjust to determine the numbers of shares to be awarded to each claimant on the basis of the numbers on the face of the certificates issued, in the light of the proof that in many important respects Malakoff disre-

garded the corporate entity. There is no difficulty in assigning the adjective "technical" to the consideration of the number of shares set forth on each certificate issued by Malakoff.

112. Davidson argues that a Board of Directors has the power to fix the consideration charged and to be received for shares of stock, and that each investor should be given the benefit of his bargain. The defect in this argument is obvious. There never was a Board of Directors of the [fol. 269] debtor acting at any time during which Malakoff was promoting and managing Nazareth. Even if Malakoff alone be deemed to have constituted a Board of Directors, the criteria used by him, in the case of the investments in which the numbers of shares promised and issued represented deliberate choices and were not arbitrary or fortuitous, were hardly those which could pass a test of good faith.

113. As in its application to the first problem of classification, the application of the third stated principle of equity is self-evident and almost mathematical in its certitude and definiteness. Each net dollar invested in Nazareth by each claimant-stockholder should purchase an equal fraction of a share of its stock.

114. The problem of over-issuance, in connection with which both Davidson and the debtor depart from equity and return to technical rules of law, does pose a serious question as to whether an almost absolute rule of the law of corporations overrides considerations of equity. This is discussed at a later point in this Report. Reserving that question, there is utterly no problem as to the result dictated by the equitable principles stated above.

115. The number of shares authorized by the disregarded certificate of incorporation of an almost completely disregarded corporate entity is certainly "form" and not "substance". Any claim that it would be just to deny any interest in the stock of the debtor to those who made their investments and paid their consideration to Malakoff after he, deliberately or inadvertently, sold shares in excess of the authorized number, would have to be dismissed as sham

[fol. 270] and frivolous. No such claim is made by either the debtor or Davidson. The claim that overissued shares are absolutely void rests upon a purportedly absolute rule of law, not on any equitable principles.

116. In connection with the over issuance problem, the equality which is equity is clearly equality as between those who innocently and unknowingly invested or received their shares after the authorized 200 had been accounted for and those who did so before the authorized 200 had been accounted for. This maxim of equity requires that the over issuance be disregarded, in the absence of an absolutely controlling rule of law requiring a contrary conclusion.

117. Each of the three stated principles of equity has been applied to each of the three problems involved in the determination of the basic question before this court. If the stated equitable principles are to govern the determination of the debtor's objections to the 36 proofs of stock interest, only one answer can be given by this court to the basic question before it: each claimant-stockholder who gave value to Malakoff for an interest in Nazareth should be deemed to be a valid and bona fide stockholder of the debtor and should be deemed the owner of that proportion of 200 shares, which his net investment, as hereinbefore valued, bears to the total of all the net investments, as hereinbefore valued, by all claimants deemed to be valid stockholders. As stated, the dividends represent the return of capital and have been considered in computing the net investment of each stockholder.

[fol. 271] 118. In the opinion of the Examiner, not only is there no overriding rule of law compelling a determination different from that which follows from the application of the three stated principles of equity, but applicable rules of law themselves support and require the same determination. The applicable rules of law, and some which are inapplicable, are discussed below.

The Applicable and Inapplicable Rules of Law

119. It is conceded by all parties and must be found as a fact by this court that the debtor itself received nothing directly from the sale and issuance of all of the shares of

stock held by the claimants-stockholders. Nor did any of the claimants prove the indirect receipt by the debtor of the consideration paid to Malakoff. This want of consideration by the debtor itself for the issuance of its shares of stock can, at the most, render such shares voidable, and not absolutely void. *Bradford County Tel. Co.* v. *Young*, 329 Pa. 433, 198 Atl. 96 (1938); *Kathiotes* v. *Mosler*, 89 D. & C. 174 (Pa. 1955); *In re Dissolution of New Oxford Shoe Co.*, 45 D. & C. 53 (Pa. 1942); *Grafton* v. *Musteller*, 232 F.2d 773 (3d Cir. 1956) cert. den. 352 U.S. 832 (1956); cf. Pa. Const. Art. XVI, § 7, Pa. B.C.L. 603(A), 15 Pa. Stat. Ann. § 2852-603(A) (Purdon 1958).

120. The debtor does not now urge this lack of consideration by the debtor itself as a ground of objection to all claims of stock interest. It does seek to limit the allowance [fol. 272] of such claim to those who paid a present consideration to Malakoff, and to disallow the claims of stock interest by those who took shares of stock of the debtor in payment of antecedent indebtedness by Malakoff, or as security for the payment of such antecedent indebtedness.

121. The proper definition and concept of "consideration" does not support this position of the debtor. It is generally recognized that discharge of an antecedent debt is consideration. See, e.g. N.Y. Pers. Prop. Law § 183(1) (Uniform Stock Transfer Act § 22, 6 U.L.A.):

> "'Value' is any consideration sufficient to support a simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a certificate is taken either in satisfaction thereof or as security thereof."

See also, 15 Pa. Stat. Ann. §§ 301-324 (repealed by Uniform Commercial Code in 1953); N.Y. Pers. Prop. Law § 156(1); U.C.C. §1-201; 1 Corbin, Contracts § 212, p. 701 (1950).

122. The transfer of stock as security for an antecedent debt constitutes consideration in Pennsylvania and in New York under the Uniform Stock Transfer Act. 6 U.L.A. § 22, N.Y. Pers. Prop. Law § 183(1) supra; 15 Pa. Stat. Ann. §§301-324 (repealed in 1953 by U.C.C.).

123. The tangled and confused history of the debtor and of the operations of Malakoff as its promoter and manager have rendered it impossible for this court to determine whether the shares of stock which he caused to be issued to the claimants-stockholders herein were newly issued shares or shares transferred from and by him. Whichever conclusion is the correct one, however, each claimant-[fol. 273] stockholder who paid money to Malakoff for an interest in Nazareth, or took an interest in satisfaction of an antecedent indebtedness by Malakoff to him, or took an interest in Nazareth to secure the payment of such an antecedent indebtedness remaining unpaid, gave "consideration" for shares of stock of the debtor. The distinction and classification urged by the debtor is contrary to the applicable substantive law as well as contrary to the broad equitable principles which the debtor itself urges upon this court.

124. Law as well as equity requires that the number of shares awarded to each claimant deemed to be a valid owner of shares be determined on the basis of the amount of his or her net investment, not on the basis of the number of his shares set forth on the certificates.

125. The certificates issued by Malakoff to the claimants-stockholders herein are not the shares of stock owned by them. They are mere muniments of title, and only *prima facie* or some evidence of the number of shares owned by the holders of such certificates.

Commissioner v. *Crompton*, 137 Pa. St. 138, 28 Atl. 417 (1893);
Keystone Wrapping Machinery Co. v. *Bromeier*, 42 Pa. Super. 384 (1909).

126. The conduct of Malakoff himself is of far greater weight in determining the number of shares owned by each claimant than are the numbers set forth on the face of the certificates issued to the claimants. The most significant factor in determining the proportionate interest which each claimant had in Nazareth is the amount of the "dividends" which Malakoff paid to each claimant. This was [fol. 274] his true valuation of the investment by each claimant and was accurately based upon the dollar amount of such investment.

127. It is true that a corporation may sell and issue stock at varying prices and for varying amounts and kinds of consideration, as Davidson argues. The policy of the law in this regard is simply to give to each purchaser of stock without par value, or at a price above par value, the benefit of an honest bargain, a policy no different from that applied to persons buying or selling automobiles or grapes. In the case of the debtor herein and Malakoff, however, this principle can only be applied if the court throws away the thousands of pages of testimony which it so patiently heard and received, and treats the debtor as a corporation, and Malakoff as a president of a corporation carrying on its business, in strict conformity to all of the rules of corporate organization, law and procedure. There was no Board of Directors fixing the nature or amount of consideration to be received for the stock which Malakoff issued. Malakoff was not even selling shares of stock as such. He was selling fractional interests in Nazareth, primarily by promising 20% annual return on the number of dollars invested by each buyer of an interest.

128. It is by examining closely the nature of the business enterprise which Malakoff created, and finding and applying the rules of law governing such a business enterprise, not by applying the textbook rules governing regularly constituted and operating corporations, that the correct legal relationship of the debtor and the claimants-stockholders can be determined.

[fol. 275] 129. Malakoff completely dominated and controlled the debtor. There were virtually no meetings of the directors of the debtor during the period of the control of it by Malakoff and no meetings of stockholders. Malakoff regarded the debtor corporation as a mere instrumentality of his own to conduct the business of Nazareth, the form of which he deemed himself able to change at will. For stock purposes he did not consider the debtor as a legal entity separate and apart from himself. He alone was the responsible agent causing the issuance of its stock. He alone received and used the moneys paid by various claimants, or cancelled his personal indebtedness by issuing shares to claimants, or transferred shares as security for

the payment of such antecedent indebtedness. The moneys which he received were commingled with other of his funds emanating from investors, real estate deals and other sources. Malakoff caused "dividends" to be paid to the claimants on their investments in the debtor, but no Board of Directors ever met to consider the declaration and payment of any such "dividends". Until shortly before the institution of the reorganization proceedings herein the payments were made with his checks drawn on his own personal accounts and not on any accounts of the debtor. "Dividends" were not paid from the profits of the debtor. The funds for the "dividends" were funds of Malakoff's, obtained at times through loans at usurious rates of interest and through check-kiting devices.

130. To the majority of investors in Nazareth, the claimants-stockholders herein, it was no more a separate corporate entity than to Malakoff. The investors, by and large, did not consider themselves to be purchasing shares [fol. 276] of corporate stock, but did consider themselves to be investing in Nazareth as a business enterprise or simply investing money in Malakoff, on his promise of a 20% annual return. All of the investors' money was paid to Malakoff alone. They knew and understood that the basis of payment of "dividends" to them was the money invested, not the number of shares received. The very receipt which most of them were given by Malakoff was one in which he asserted the unilateral power to at any time change the form of business association of himself and the investors to that of a limited partnership or some other form. Most of the investors were unsophisticated in the ways of business organization and financing and did not understand or regard as of any real importance whether they were receiving stock in a corporation or some other evidence of an interest in some form of business association with Malakoff.

131. It is unnecessary to find the correct legal term to describe the type of business enterprise which Malakoff created out of the Nazareth Market, if there is any term in legal literature which can correctly describe the unique form of enterprise which he created. It is both wrong and

unjust for this court to attempt to pick some orthodox term from the literature of law or finance to describe the unique creation of Malakoff which is the debtor, and then apply a body of law fashioned to govern ordinary enterprises of that type in ordinary situations. In one sense, Nazareth was a corporation *de jure*, because its Articles of Incor- [fol. 277] poration were duly received and a Certificate of Incorporation duly granted. In another case, it was merely a *de facto* corporation, because it never actually completed its organization by the regular issuance of stock, the regular election of directors and officers, and the regular conduct of meetings of stockholders and directors and other corporate activities. In still another sense, it was simply a joint venture, with Malakoff as the managing venturer.

132. Whatever the correct term is that should be applied to the debtor, this court is permitted and required, for purposes of determining who are the owners of the debtor and in what proportions:

(1) to disregard the corporate entity of the debtor;

(2) whether or not the corporate entity is disregarded, to treat Malakoff and the claimants-stockholders as joint venturers.

133. No detailed citation or discussion of the authorities in connection with the disregarding of a corporate entity, sometimes referred to as the piercing of a corporate veil, is needed. There is no doubt that Nazareth and Malakoff were *alter egos*.

Barkin Const. Co. v. *Goodman*, 221 N.Y. 156, 116 N.E. 770 (1917);

Chestnut St. Trust & Savings Fund Co. v. *Record Pub. Co.*, 227 Pa. 235, 75 Atl. 1067 (1910);

Allen v. *France Packing Co.*, 170 Pa. Super. 632, 90 A.2d 289 (1952);

[fol. 278] *Jackson* v. *M. H. Thomas Inv. Co.*, 46 F 2d 252 (5th Cir. 1951);

Mosher v. *Salt River Valley Water Users Assn.*, 39 Ariz. 567; 8 P.2d 1077 (1932).

134. Consideration of the facts in other cases in which corporate entities for one or more purposes have been disregarded is equally pointless. Suffice it to say that a case with more ample justification than the case of this debtor for disregarding a separate corporate entity, for whatever purpose or purposes necessary to prevent injustice, would be difficult to conceive or imagine. It is hardly possible to construct by hypothesis a corporation which would be more of a mere instrumentality of its dominant promoter, officer, stockholder and manager than the debtor herein was of Malakoff.

135. Under these circumstances, and with this court fully empowered and indeed required by every consideration of fairness, justice and equity to pierce what was hardly even a veil between Malakoff and the debtor corporation, the ordinary requisites of the validity of the issuance of stock become mere academic niceties. To talk of the performance of such ordinary requisites for the issuance of stock in the case of Nazareth is to construct a whole world of corporation law, practice, custom and ritual which never existed in the mind of Malakoff, or in that of most of the claimants-stockholders. It is upon understanding the true nature of Nazareth as a business enterprise, and not as a corporate entity which never existed in actuality, that the answers to the problems of allocation of shares and of the so-called over-issuance of shares, as well as that of "consideration" for shares, be-[fol. 279] come clear and compelling.

136. If the claimants-stockholders invested in Nazareth the business enterprise and not Nazareth, the corporate entity, there is no problem of consideration to the debtor itself. Consideration to Malakoff can be treated as consideration to the debtor, justifying the sustaining of the claims of stock interest interposed by the claimants-stockholders herein on the basis of such consideration. The certificates of stock received by the claimants, and their designations of numbers of shares, are not even muniments of title or *prima facie* evidence of the proportionate interests of their holders in Nazareth as an enterprise.

137. If the interests of the claimants-stockholders are deemed interests in Nazareth the business enterprise and not in Nazareth the corporation, nominally limited to 200 shares of stock, there is no problem of over-issuance. This court need only determine the proportionate interest in the whole business entity held by each of the claimants-stockholders, the basis of which determination should be the basis upon which Malakoff himself determined their proportionate interests, the consideration paid in money or money's worth by each investor. Whatever the nature of the capital structure and number of shares to be issued by the debtor herein, as provided for in any Plan of Reorganization hereafter approved and confirmed, such proportionate interests can and should be respected.

138. There is ample authority for determining the interests of the claimants-stockholders in Nazareth as joint venturers, whether or not the corporate entity of the [fol. 280] debtor be disregarded. The relationship between Malakoff and those who invested in Nazareth before the filing of the Articles of the debtor's Articles of Incorporation was that of joint venturers. The basis upon which Malakoff sold interests and upon which the claimants-stockholders purchased interests after the filing of its Articles, was also that of joint venture. The fact that the enterprise took the form of a corporation, whether the separate entity of the corporation be recognized or disregarded, did not destroy the joint venture.

DeBoy v. *Harris*, 207 Md. 212, 113 A.2d 903 (1955);
Denny v. *Guyton*, 327 Mo. 1030, 40 S.W.2d 562 (1931);
Beardsley v. *Beardsley*, 138 U.S. 262, 34 L.Ed. 928 (1891);
Sweet v. *Watson's Nursery*, D.C. of Appeals 4th Dist. Cal. (1939) 33 Cal.App.2d 699, 92 P.2d 812;
Watkins v. *Delahunty*, 133 App.Div. 422, 117 N.Y.S. 885 (1909);
Cf. *Jackson* v. *Hooper*, 76 N.J.Eq. 592, 75 A. 568 (1910);

Manacher v. *Central Coal Co.*, 284 App.Div. 380 (1954), 131 N.Y.S.2d 671.

139. Under the now majority rule, whenever parties to a joint venture agree to operate through the medium of a corporation, the joint venture agreement is not superseded by the organization of the corporation. This conclusion is based upon:

(1) Court's policy to give expression to the joint venture agreement; and

[fol. 281] (2) The belief that where third parties and creditors are not adversely affected, there are no policy considerations compelling abrogation of the agreement.

140. In the leading case of *DeRon* v. *Harris*, supra, the plaintiff and defendants Harris and Smith orally agreed to form a joint venture for the purpose of building commercial properties. The respective capital contributions were to be the measure of a fixed percentage ownership in the assets and profits of the venture and these interests were to be fixed by the issuance of stock in a corporation which was to be formed to act as an instrumentality of the venture. Some years after formation of the contemplated corporation, the defendants, over plaintiff's objection, increased the authorized shares of the corporation and caused the issuance of additional stock to defendant. Though the plaintiff was given the opportunity to participate in the issue he brought an action for damages claiming that the defendants' action was a direct violation of the joint venture agreement. The Maryland Court of Appeals overruled the defendants' demurrer and held that the plaintiff had stated a cause of action for an equitable accounting.

141. If the rights of stockholders of *de jure* corporations, regularly organized and operating and observing all of the rules and procedures of corporate law and procedure, can be determined by considering them members of a joint venture operating in the form of a corporation, this court may certainly do so with respect to the rights of the claimants-stockholders herein. If the relationship of Mala-[fol. 282] koff and the claimants-stockholders, for purposes

of determining who owns the debtor is deemed to be that of venturers, there is no requirement of the payment of consideration to the debtor itself. The payment of consideration to Malakoff, as the managing adventurer, establishes the interest of each investor in the venture. The proportion of the interest of each is determined by the amount of his investment in the venture, as evidenced by the accounts of the managing adventurer, Malakoff, to wit, the payment of "dividends". There is no problem of over-issuance because each investor is determined to have the fractional interest in the entire enterprise which the amount of his investment bears to the total of all investments. The proportions of the interests so determined become the proportions of the total number of shares of stock issued by the corporate entity through which the venture operates, which will be the debtor as reorganized, pursuant to any approved and confirmed Plan of Reorganization.

142. One additional and independent ground exists for disregarding any problem of over-issuance. It is true that an over-issuance of stock by a corporation or promoter has in some cases been held to be absolutely void. *Mount Holly Paper Co.* Appeal, 99 Pa. 514 (1882); *Wright's* Appeal, 99 Pa. 425 (1882); 12 A Pa. Stat. Ann. §8-104 (U.C.C.).

143. To hold any of the shares claimed by the claimants-stockholders herein void on account of over-issuance, however, this court must determine whose shares were and are the over-issued shares. The fact is that no rational or just basis appears in the record for any such determination. To [fol. 283] simply take the certificates of stock in the order that their numbers bear until the aggregate of the shares represented thereby is 200 and deem all beyond that over-issued and void, is obviously unjust. The order in which Malakoff made out certificates to the investors and the numbers assigned to the certificates, as well as the dates when he issued such certificates, were purely fortuitous or arbitrary. To take as a basis for determining the over-issued shares the order in which investors agreed to subscribe for shares, is likewise unjust. It is also impossible because the facts upon which such a determination must be based are not in the record. This is likewise true with

respect to using the order of payment of consideration for the shares.

144. To determine which shares are over-issued and thus void, this court would have to determine which shares are valid. As is admitted by all parties, and hereinbefore pointed out in this Report, none of the claimants-stockholders has a valid legal claim to any shares. It can, therefore, be fairly stated that no claimant has validly held any shares. It is this court alone which, by orders entered herein, will validate shares. In this sense, there has been no over-issuance because there were no 200 shares or any number of shares validly issued prior to the unknown and unknowable date or dates when the "over-issued" shares were subscribed for or issued. Furthermore, in a very real sense, the equitable maxim, "He who seeks equity must do equity" should be applied, since it is only their search and finding of equity through this court that those claimants, whoever they may be, who were issued the first 200 shares [fol. 284] have any valid shares at all.

145. This inability of the court to determine which of the shares are over-issued is itself sufficient reason for disregarding any problem of over-issuance. It can fairly be said that few if any courts have ever been more patient in extending every opportunity to seemingly inexhaustible and indefatigable litigants and their attorneys to prove their respective claims. The failure by both of the principal adverse parties, the debtor and Davidson, to furnish this court with any rational basis for determining whose shares are the over-issued shares is reason enough for this court's following the determination dictated by the equitable principles which all parties urge upon this court.

Conclusion

146. Both equitable principles and applicable rules of substantive law justify and require holding that each claimant-stockholder who invested in Nazareth by the payment of money to Malakoff, or accepted shares of the debtor's stock in payment of antecedent indebtedness of Malakoff or as security for such indebtedness of Malakoff, be

deemed the valid owner of shares of stock of the debtor, in the proportion which the fair value so paid by each claimant-stockholder bears to the aggregate amount of all such values paid, in each case subtracting dividends.

Annexed hereto as "Exhibit A" is a schedule setting forth the name of each claimant-stockholder, the certificate number or numbers of the certificate or certificates standing in said claimant's name, the total number of shares claimed [fol. 285] by each claimant, the dollar amount of consideration paid by each claimant, the net value of the investment of each claimant as determined above adjusted to the nearest multiple of $10, and the proportion of the total number of the 200 shares of the debtor's capital stock which the Examiner recommends be awarded to each claimant.

No recommendation is made by the Examiner at this time with respect to the counterclaims by the debtor against claimants-stockholders. The proportions of the stock of the debtor which the claimants-stockholders are deemed to own are subject to adjustment in the event that this court upholds, upon review, the claims of the Margolis group.

Respectfully submitted,

Charles Seligson, Examiner.

Dated: New York, New York, April 21, 1960.

[fol. 286]

Name of Claimant	Certificate No.(s)	Number of Shares Claimed	Consideration Paid	Total Dividend Received	Adjusted Net Value	Recommended Proportion of Stock
A. Bikales	16	5	$5,000.	$1,666.80	$3,330.	3330/173,450
M. Bluestone	24	2	2,000.	566.78	1,430.	1430/173,450
C. Bond	48	1	1,000.	33.34	970	970/173,450
B. Clark	12	4	4,000.	1,316.73	2,680	2680/173,450
D. Clark	11	3	3,000.	768.40	2230.	2230/173,450
F. Como	9 41	4 2	6,000	1,366.73	4,630.	4630/173,450
L. Como	7 42	4 2	6,000.	1,466.73	4,530	4530/173,450
P. Como	37 38	6 2	8,000.	326.66	7,670	7630/173,450
H. & M. Danciger	74	11	10,946.97	-o-	10,950	10,950/173,450
H. Forman	59 73	5 5	10,000.	-o-	10,000.	10,000/173,450

[fol. 287]

Name of Claimant	Certificate No.(s)	Number of Shares Claimed	Consideration Paid	Total Dividend Received	Adjusted Net Value	Recommended Proportion of Stock
S. Forman	49	15	13,000.	-0-	13,000	13,000/173,45
A. Fried	25	3	3,000	683.41	2,32	2320/173,450
J. Fried	15	3	2,000	633.-0	1,370	1370/173,450
C. Grossman	61	2	2,000	72.22	1,930.	1930/173,450
R. Hull	6	4				
	62	2	3,600.	1,200.00	2,400.	2400/173,450
D. Kane	19	3	3,000.	950.01	2,050.	2050/173,450
C. Kanter	71	8				
	72	20				
	4	12	20,800.	3,800.	17,000.	17,000/173,45
R. Kaplan	40	1	1,000.	16.67	980.	980/173,450
L. Karapontso	39	2	2,000.	188.92	1,810	1810/173,450
F. Katzenell	51, 52, 53, 54, 55, 56	35	16,850.	7,250.	9,600	9600/173,450
	57					

[fol. 288]

Name of Claimant	Certificate No.(s)	Number of Shares Claimed	Consideration Paid	Total Dividend Received	Adjusted Net Value	Recommended Proportion of Stock
G. Klein	6	14	14,000.	2,534.22	11,470	11,470 / 173,450
M. Klein	22	4	3,350	566.68	2,780.	2780 / 173,450
H.L. Laupheimer	23	8	7,750	1,794.45	5,960	5960 / 173,450
E. Manoochehrian	36	14	11395.75	177.75		
	63	6	11,428.58	211.11	11,220.	11,220 / 173,450
H. Masur	13	4	4,000.	1,333.40	2,670.	2670 / 173,450
R. Noire	58	5	5,000	-0-	5,000.	5000 / 173,450
E. Pollak	31	9	9,000	600.00	8,400.	8400 / 173,450
A. Rosen	27	6	6,000	1,569.43	4,430.	4430 / 173,450
M. Samet	5	2	2,000	700.14	1,300.	1300 / 173,450
L. Saul	20	3	3,000	950.00	2,050.	2050 / 173,450
G. Schwartz	30	2	2,000.	83.35	1,920.	1920 / 173,450

[fol. 289]

Name of Claimant	Certificate No.(s)	Number of Shares Claimed	Consideration Paid	Total Dividend Received	Adjusted Net Value	Recommended Proportion of Stock
H. Schwartz	29	4	4,000.	308.37	3,690.	3690/173,450
T. Schwartz	60	3	3,000	-0-	3,000.	3000/173,450
R. Spielholz	21	3	3,000	426.67	2,570.	2570/173,450
L. Treat	17	2	2,000	666.80	1,330.	1330/173,450
A. Weinstein	18	7	7,000	2,216.54	4,780.	4780/173,450

SEE EXPLANATORY NOTE

[fol. 290] NOTE

The figure of 173,450, the denominator in each fraction in the column "Recommended Proportion of Stock" represents the sum of the figures in the column "Consideration Paid" minus the sum of the figures in the column "Total Dividend Received." The numerator in each fraction in the column "Recommended Proportion of Stock" represents the amount of "Net Consideration Paid" applicable to each claimant rounded off to the nearest multiple of $10. The denominator in the fractions in the column "Recommended Proportion of Stock" has been rounded off to the nearest multiple of $10.

[fol. 293]

IN UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

No. 89669

[Title omitted]

PETITION FOR REMOVAL OF PRESIDENT, SECRETARY-TREASURER AND GENERAL MANAGER OF DEBTOR FOR MISCONDUCT IN OFFICE AND FOR TERMINATION AND RECOUPMENT OF COMPENSATION—Filed June 23, 1960

To the Honorable Sidney Sugerman, Judge of the United States District Court for the Southern District of New York:

The Petition of Irving J. Wolf, respectfully represents:

1. On September 28, 1953, Nazareth Fair Grounds & Farmers' Market, Inc. (hereinafter called "Nazareth" and the "Debtor"), filed a petition herein, verified September 25, 1953, which petition prayed that proceedings be had under Chapter X of the Bankruptcy Act; and by orders dated September 28, 1953, this Court approved said petition and continued the Debtor in possession; and said Debtor continues in possession at present.

2. Petitioner is the nominal owner and holder of forty (40) shares of stock in Nazareth registered in the name of Charles Kanter, and assigned to Petitioner on December 5, 1957; the beneficial interest is in his principals, Wilson D. Rehrig and Frederick Katzenell, for whom Petitioner is agent and attorney-in-fact, pursuant to Agreements dated December 5, 1957, heretofore filed herein.

[fol. 294] 3. Since June 29, 1953, Arnold A. Weinstein (hereinafter called "Weinstein") has been President and a director of the Debtor; and H. Lawrence Laupheimer (hereinafter called "Laupheimer") has been Secretary-Treasurer and a director of the Debtor; and Jerome Fried (hereinafter called "Fried") has been General Manager of the Debtor. By orders of this Court dated September 28, 1953, Weinstein, Laupheimer and Fried were authorized to continue serving in the aforesaid offices. By orders of this Court dated September 28, 1953, April 28, 1955, May 19, 1955, June 14, 1955, and January 13, 1956, the Debtor was authorized to pay certain compensation to Weinstein and Fried for services rendered by them to the Debtor, and to reimburse them for certain expenditures made by them; and Weinstein and Fried have regularly received such compensation and reimbursement pursuant to the aforesaid orders. Nazareth Enterprises, Inc. is a Pennsylvania corporation, the stock of which is owned in equal shares by Fried and his wife, and the president of which is Fried.

4. Petitioner complains of Weinstein as President and a director of the Debtor, and of Laupheimer as Secretary-Treasurer and a director of the Debtor, and of Fried as General Manager of the Debtor, and specifies the following causes and grounds for their removal from their respective offices and for the termination and recoupment of compensation and reimbursement by the Debtor:

A. Trading in Stock of Debtor

5. On or about May 7, 1957, Weinstein purchased two-thirds (⅔) of one (1) share of stock in Nazareth from Laupheimer.

[fol. 295] 6. On or about May 7, 1957, Laupheimer purchased one (1) share of stock in Nazareth from Dorothy Holober Clark, and sold two-thirds (⅔) of said share to Weinstein.

7. On or about December 24, 1957, Jerome Fried purchased the interest of Eskander Manoochehrian in his twenty (20) shares of stock in Nazareth; and on or about September 11, 1958, Jerome Fried sold ten (10) of the aforesaid twenty (20) shares to Eskander Manoochehrian, leaving Jerome Fried with a beneficial interest in ten (10) of the aforesaid twenty (20) shares.

8. On or about December 1, 1957, fourteen (14) persons who are stockholders of record of Nazareth, and who have filed proofs of interest herein claiming ownership of stock in Nazareth, signed (personally or by representatives) a certain "Agreement of the Stockholders", whereby each signatory granted to the other signatories an option or "right of first refusal" to purchase their respective shares of stock in Nazareth. Weinstein, Laupheimer and Fried were each signatories of said Agreement, and solicited the signatures and acceptances of the other signatories. Other signatories included Barry Clark, Dorothy Holober Clark, and Lazar Karapontso.

9. On or about May 7, 1957, Weinstein's sister, Mrs. Blanche Waldman, purchased the aggregate interests of Harold Q. Masur and Lawrence Treat in their six (6) shares of stock in Nazareth. Weinstein acted as his sister's agent in said acquisitions.

10. On or about March 3, 1959, Fried exercised his option under the aforesaid Agreement of Stockholders dated December 1, 1957, whereby he offered and demanded [fol. 296] to purchase the interest of Barry Clark in his four (4) shares of stock in Nazareth, the interest of Lazar Karapontso in his two (2) shares of stock in Nazareth, and the interest of Dorothy Holober Clark in her remaining two (2) shares of stock in Nazareth. On or about April 10, 1959, Fried purchased the aforesaid shares of Barry Clark and Lazar Karapontso. Weinstein acted as Fried's agent in said acquisitions.

B. Diversion or Embezzlement of Property of Debtor

11. On August 18, 1952, Nazareth as Lessor and Joseph Sherman (hereinafter called "Sherman") as Lessee entered into a purported lease providing for Sherman's conducting a stock-car racing enterprise on the Debtor's property. Said lease was executed for the Debtor by Fried as General Manager. At the time of said execution and until April 28, 1953, Fried was a partner of Sherman's in the racing enterprise. On April 28, 1953, Sherman assigned his interest in said lease as tenant to Nazareth Enterprises, Inc.; and since then Nazareth Enterprises, Inc. has conducted the racing enterprise. Paragraph 3 of the aforesaid lease dated August 18, 1952, provides as follows:

> "3. In consideration whereof Lessee agrees to pay to Lessor the sum of Twelve (12%) percent of the gross admissions in the features set forth in Paragraph 1. However, on those days that the Lessee operates the food concessions for the events set forth in Paragraph 1, he shall pay the Lessor Fifteen (15%) percent of the gross admissions."

12. Commencing in 1954, Nazareth Enterprises, Inc. as Lessee, has paid the Debtor, as Lessor, only ten (10%) percent of the gross admissions on some or all of the days when Nazareth Enterprises, Inc. has operated the racing enterprise on the Debtor's property.

[fol. 297] 13. Payment to the Debtor by Nazareth Enterprises, Inc. of less than the full rentals required by the aforesaid lease dated August 18, 1952, was made with the knowledge and consent of Weinstein, Laupheimer and Fried, and without disclosure thereof to this court until April 20, 1959, and without approval thereof by this Court.

14. J & J Foods, Inc. (hereinafter called "J & J") is a Pennsylvania corporation, at least one-half (½) the stock of which is owned by James LaGrotte or his wife or both, and the officers and directors of which include James LaGrotte and his wife (hereinafter called collectively "LaGrotte"). Since prior to September 28, 1953, and

until the present, J & J or LaGrotte has been a lessee of the Debtor as lessor, and has operated a bake shop and certain prepared-food dispensaries on the Debtor's premises pursuant to certain leases providing for graduated percentage rentals of between ten (10%) percent and fifteen (15%) percent of the gross receipts of J & J or LaGrotte. The operations of J & J or LaGrotte include the sale of prepared food on the Debtor's property at the times when Sherman and Nazareth Enterprises, Inc. have conducted the racing enterprise.

15. Prior to 1954, and subsequent to September 28, 1953, J & J or LaGrotte paid Fried or Nazareth Enterprises, Inc. the percentage rentals provided for in their leases and based on gross receipts from the sale of prepared food on the Debtor's property at the times when Sherman and Nazareth Enterprises, Inc. conducted the racing enterprise; and Fried or Nazareth Enterprises, Inc. received such payment from J & J or LaGrotte, and purportedly accounted [fol. 298] to the Debtor for such rentals received, and said rentals were remitted to the Debtor or deposited to the Debtor's bank account.

16. Commencing in 1954, Fried or Nazareth Enterprises, Inc. has received from J & J or LaGrotte payment of percentage rentals of between ten (10%) percent and fifteen (15%) percent of the gross receipts of J & J or LaGrotte from the sale of prepared food on the Debtor's property at the times when Nazareth Enterprises, Inc. has conducted the racing enterprise. Fried has not properly accounted to the Debtor for such rentals received, and said rentals have not been wholly remitted to the Debtor or deposited to the Debtor's bank account; but instead said rentals have been retained in whole or in part by Nazareth Enterprises, Inc. or Fried or both.

17. Retention by Nazareth Enterprises, Inc. or Fried of some or all of the percentage rentals paid by J & J or LaGrotte and based on the gross receipts of J & J or LaGrotte from the sale of prepared food on the Debtor's property at the times when Nazareth Enterprises, Inc. has conducted the racing enterprise, has been accomplished

with the knowledge and consent of Weinstein, Laupheimer and Fried, and without disclosure thereof to this Court until April 20, 1959, and without approval thereof by this Court.

18. By reason of the foregoing, and directly or indirectly, this estate has been depleted; and Fried has knowingly and fraudulently appropriated to his own use, embezzled, spent, or transferred property belonging to this estate which came into his charge as trustee, receiver, custodian, or other officer of this Court; and Weinstein and Laupheimer have aided and abetted Fried in the premises.

[fol. 299]

C. Other Unauthorized Transactions

19. In 1957, Robert F. Sell (hereinafter called "Sell") was engaged or employed by the Debtor to pave the Debtor's parking lot; and the Debtor contracted with Sell, and incurred a liability to him, to pay therefor the principal sum of $15,329.25, plus interest thereon. Subsequently, interest was disallowed or waived, and this Court authorized the Debtor to pay the principal balance then owing to Sell, by order made on or about March 23, 1959.

20. On or about July 15, 1957, the Debtor entered into a contract with Melville A. Carty (hereinafter called "Carty"), whereby the Debtor borrowed from Carty the sum of $30,000, and agreed to repay Carty the principal in installments, with interest thereon in excess of six (6%) percent annually; and the Debtor assigned certain of its leases and future rents to Carty as security for and payment of said loan. Subsequently, interest was disallowed or waived, and this Court has authorized the Debtor to pay the principal balance now owing to Sell, by oral order made December 21, 1959, and not yet formally entered.

21. In 1957, the Debtor constructed an annex or addition to its new building, for use as an office, at a cost to the Debtor exceeding the sum of $6,000. Subsequently, said construction was approved, by order of this court made on or about May 19, 1958.

22. Notice of each of the aforesaid transactions described in Paragraphs 19, 20 and 21 was first given to this Court by persons other than Weinstein, Laupheimer and Fried, and subsequent to the occurrence of each respective transaction.

[fol. 300] 23. Each of the aforesaid transactions described in Paragraphs 19, 20 and 21 was entered into and engaged in, by Weinstein, Fried and Laupheimer, or with their knowledge and consent, but without prior disclosure thereof to this Court of prior approval thereof by this Court; and in the absence of such prior disclosure and approval, each of said transactions was initially unauthorized and void, and constituted misconduct by Weinstein, Laupheimer and Fried.

D. Improper Solicitation of Acceptances of Plan

* * * * * * *

[fol. 301] 29. Petitioner and his principals and attorney, have complied with all applicable laws regulating their activities and personnel.

30. Arnold A. Weinstein has appeared herein for himself; H. Lawrence Laupheimer has filed a proof of interest which does not reveal the name of any attorney, and has appeared herein lately for himself; Jerome Fried has appeared herein by Meyer Kraushaar, and lately for himself; Nazareth Enterprises, Inc. has not appeared generally herein; the Debtor has appeared herein by Alex L. Rosen; the Court has appointed Charles Seligson as Examiner herein, and the Court has directed that said Examiner receive notice generally herein or with respect to the subject matter of this Petition; and no other person has been designated to receive notice generally or with respect to this matter.

31. On or about March 16, 1959, Petitioner submitted to this Court his Petition, verified March 13, 1959, seeking [fol. 302] Termination and Recoupment of Compensation (Pursuant to Section 249 of the Bankruptcy Act) and

naming Weinstein, Laupheimer, Fried and Nazareth Enterprises, Inc. as respondents; said Petition first came on for hearing before this Court on March 23, 1959, and is now pending. Except for said Petition, no previous application has been made for the relief prayed for herein.

Wherefore, Petitioner prays:

(A) That Arnold A. Weinstein, H. Lawrence Laupheimer, and Jerome Fried be removed from their respective offices as President, Secretary-Treasurer, General Manager, and Directors of the Debtor (as the case may be);

(B) That hereafter in this proceeding, no compensation or reimbursement of expenses be allowed or paid to Arnold A. Weinstein, Jerome Fried, and Nazareth Enterprises, Inc. or any of them;

(C) That Arnold A. Weinstein, Jerome Fried, Nazareth Enterprises, Inc., and each of them, account to this Court for all compensation and reimbursement of expenses received by them heretofore from the Debtor for the period from and after September 28, 1953, and that Arnold A. Weinstein, Jerome Fried, Nazareth Enterprises, Inc., and each of them, restore to the Debtor, and that the Debtor recoup from each of them, all such compensation and reimbursement; and

(D) That Petitioner have such other and further relief as is just.

Dated: New York, New York, January 5, 1960.

Irving J. Wolf, as Assignee of Charles Kanter and as Attorney-in-Fact and Agent of Wilson D. Rehrig and Frederick Katzenell, Petitioner.

Melvin Lloyd Robbins, Attorney for Petitioner, Office & P.O. Address, 9 East 40th Street.

[fol. 303] *Duly sworn to by Irving J. Wolf, jurat omitted in printing.*

[fol. 304] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In Reorganization No. 89669

In the Matter

of

NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., Debtor.

NOTICE OF SETTLEMENT OF PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW INCIDENT TO ORDER AND JUDGMENT MADE JUNE 14, 1960, ON ELECTION PETITION—Filed August 1, 1960

Please Take Notice that the within proposed Amended Order and Judgment and Supplemented Findings of Fact and Conclusions of Law will be presented for settlement and signature herein to the Hon. Sidney Sugarman, one of the Judges of the within-named Court, at the office of the Clerk of this Court, Room 601, United States Courthouse, Foley Square, New York, New York, on the 1st day of August, 1960.

Dated: New York, New York, July 22, 1960.

Melvin Lloyd Robbins, Attorney for Petitioner, Irving J. Wolf, Office & P.O. Address: 9 East 40th Street, New York 16, N. Y.

To:

Arnold A. Weinstein, Esq., pro se, 225 Broadway, New York 7, N. Y.

Jerome Fried, pro se, 156 Pennsylvania Avenue, Easton, Pa.

H. Lawrence Laupheimer, pro se, 20 Fara Drive, Stamford, Conn.

Charles Seligson, Examiner, 350 Fifth Avenue, New York 1, N. Y.

Alex L. Rosen, Attorney for Debtor, 225 Broadway, New York 7, N. Y.

[fol. 305]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In Reorganization No. 89669

In the Matter

of

NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., Debtor.

FINDINGS OF FACT AND CONCLUSIONS OF LAW INCIDENT TO ORDER AND JUDGMENT MADE JUNE 14, 1960, ON ELECTION PETITION—August 1, 1960

At New York, New York, in said District, on the 1st day of August, 1960.

The Following Petition having duly come on before this Court by notice of motion, namely: Petition, verified August 6, 1958, for Approval of Proposed Directors and Officers of Debtor (pursuant to § 191 of the Bankruptcy Act); and the Examiner and counsel for the respective parties having been heard thereon;

Now, upon the aforesaid Petition and related pleadings, affidavits, exhibits, and memoranda of law, and upon all the proceedings heretofore had before me; and upon this Court's opinions and decisions rendered on June 14, 1960 and July 14, 1960, and the Findings of Fact and Conclusions of Law therein contained; and good and sufficient reason and cause appearing to me therefor;

The Court hereby makes the Findings of Fact and states the Conclusions of Law annexed hereto.

Sidney Sugarman, U.S.D.J.

[fol. 306]

Findings of Fact

1. On September 28, 1953, Nazareth Fair Grounds & Farmers' Market, Inc. (hereinafter called "Nazareth" and the "Debtor"), filed a Petition herein, verified September 25, 1953, by Arnold A. Weinstein as President, which Petition prayed that proceedings be had under Chapter X of the Bankruptcy Act, and further prayed for other incidental relief (Wolf's 1).

2. On September 28, 1953, this Court, by Alexander Holtzoff, U.S.D.J. (sitting by designation) signed an order incident to the aforesaid Petition (Wolf's 1), namely: Order Authorizing Debtor in Possession to Operate Business, etc. (Wolf's 4).

• • • • • • •

[fol. 308] 3. Since June 29, 1953, one formal meeting of the Nazareth stockholders was held for the purpose of electing directors of Nazareth. On August 4, 1958, a formal meeting of the Nazareth stockholders of record was held at the registered office of the Debtor in Philadelphia for the purpose of electing directors of Nazareth. Said meeting was called by Wolf and several others (as stockholders of record and their assignees), at the instance and in behalf of Wolf's principals. At said meeting, Arnold A. Weinstein and Herbert Danciger and Martin H. Philip received all votes cast as directors of Nazareth; and said directors thereupon cast all votes for Weinstein as President, Laupheimer as Vice President, Danciger as Secretary and Philip as Treasurer.

[fol. 310]

Conclusions of Law

1. The Petition, verified August 6, 1958, for Approval of Proposed Directors and Officers of Debtor (pursuant to § 191 of the Bankruptcy Act), is granted; and the election and installation of the following officers and directors is approved, namely:

(a) Weinstein, as president and a director of the Debtor;

(b) Herbert Danciger, as secretary and a director of the Debtor;

(c) Philip, as treasurer and a director of the debtor; and

(d) Laupheimer, as vice president of the Debtor.

[fol. 312] Affidavit of Service by Mail (omitted in printing).

[fol. 313]

ROSEN & ROSEN
ATTORNEYS AT LAW
225 BROADWAY
NEW YORK 7, N. Y.

ALEX L. ROSEN
MARVIN N. ROSEN

BARCLAY 7-1788
1789

July 29, 1960

Hon. Sidney Sugarman
U. S. District Judge
Southern District of New York
Foley Square
New York 7, N. Y.

Re: *Nazareth Fairgrounds & Farmers Market, Inc.*

Dear Honorable Sir:

I have received through the mails various notices, proposed findings, memoranda, etc. from Mr. Robbins on the Nazareth matter which involve Mr. Weinstein.

Mr. Robbins knew that Mr. Weinstein was going and is away on vacation and is not expected back until August 8th or 9th.

As these matters primarily involve Mr. Weinstein and in his absence may I respectfully request that Mr. Weinstein be given the opportunity to reply, be heard or submit such papers as he deems proper in the premises. No damage or prejudice could occur to anyone by giving this oppor-

tunity to Mr. Weinstein to be heard or to submit such papers as he desires.

Thanking you,

Very truly yours,

/s/ ALEX L. ROSEN
ALEX L. ROSEN

ALR:C

cc: Melvin Robbins, Esq.
Charles Seligson, Esq.

[fol. 314] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

FINDINGS OF FACT AND CONCLUSIONS OF LAW—
October 19, 1960

SIDNEY SUGARMAN, U.S.D.J.

[fol. 315] SUGARMAN, D.J.

Pursuant to an order entered herein on or about January 5, 1955, directing the filing of proofs of stock interests in the debtor, as well as proofs of claims by creditors, and 41 proofs of stock interests having been filed thereunder, aggregating 316 shares of the capital stock of the debtor, and 5 of said stock interests aggregating 54 such shares claimed by Benjamin Margolis, Ida Mae Margolis, Sarah Kason, Bernard Ungar and William McK. Schongut, having been referred to a referee in bankruptcy for trial and his recommendation thereon now pending review by this court, findings and conclusions are made as to the remaining 36 proofs of stock interests, aggregating 262 shares of the capital stock of the debtor.

Findings of Fact

1. On October 11, 1945 James A. Harter purchased the business and realty which later became that of the debtor, simultaneously executing a mortgage thereon to Rachel A. Metzger and Mildred E. Erickson for $8,500.

2. On January 11, 1949 Harter conveyed the realty and business to Nazareth Fairgrounds, Inc., a Pennsylvania [fol. 316] corporation, all of whose stock was owned by Harter and Laurena C. Shope. On that day Nazareth Fairgrounds, Inc. mortgaged the realty to Alice Kline for $14,500.

3. On March 13, 1951 Nazareth Fairgrounds, Inc. contracted to sell the business and realty of the seller to Richard Realty Co. for $66,000. This contract was entered into with the understanding that John Malakoff would acquire a one-quarter interest in the venture although actual title subsequently went to entities in which John Malakoff held no interest of record. John Malakoff acquired this one-quarter interest using in part funds supplied by Charles Kanter (Finding of Fact #18 *infra*), Gertrude Silver Klein (Finding of Fact #20 *infra*) and Morton Samet (Finding of Fact #19 *infra*).

4. On April 17, 1951 Nazareth Fairgrounds, Inc. conveyed its business and realty to Richard Realty Co., subject to the Metzger-Erickson mortgage of $8,500, the Kline mortgage of $14,500 and a purchase money third mortgage to Harter and Shope (stockholders of Nazareth Fairgrounds, Inc., the seller) for $10,000.

[fol. 317] 5. On April 20, 1951 the Kline mortgage was satisfied.

6. On May 14, 1951 Richard Realty Co. sold the business and realty aforesaid to Kipling Realty Co., subject to the remaining Metzger-Erickson and Harter-Shope mortgages. Both Richard Realty Co. and Kipling Realty Co. were Pennsylvania corporations, all of the stock of which was registered in the name of Murray Realty Co., a Pennsylvania partnership made up of Edward Malakoff and Maurice Malakoff as general partners. The corporations

were used solely as dummy corporations for the purpose of taking title to property in various real estate transactions. John Malakoff had no stock interest in either of them.

7. In July of 1951 John Malakoff orally agreed to purchase the business and real estate for the $66,000 paid by Richard Realty Co. and Kipling Realty Co., plus an unresolved amount, and approximately a week thereafter John Malakoff was put in possession of said business and realty and put his own manager in charge.

8. The debtor was incorporated under the laws of the State of Pennsylvania on or about the 7th day of August, 1951, with an authorized capitalization of 200 shares of no par value common stock.

[fol. 318] 9. On August 8, 1951 debtor's stock certificate number 1 for 10 shares was issued to Milton R. Zoloth and debtor's stock certificate number 2 for 10 shares was issued to Morris Soble, both of whom were associated in various transactions of Maurice Malakoff, one of the general partners of Murray Realty Co.

10. On September 26, 1951 Kipling Realty Co. formally transferred the business and realty aforesaid to the debtor, subject to then existing mortgages aggregating $18,000.

11. On October 17, 1951 Zoloth and Soble sold their 20 shares of the debtor's stock to John Malakoff.

12. In addition to John Malakoff's interest in and control of the venture prior to October 17, 1951, from that date and throughout the entire period of all of the transactions involved in the issuance of stock to the stock claimants herein, the debtor was dominated and controlled by him.

13. Every claimant acquired his or her shares of the debtor's stock by means of transactions with or through said John Malakoff or his agents.

[fol. 319] 14. John Malakoff commingled funds received by him from others for investment in the debtor with his own funds and with those of other corporations controlled by him.

15. Although only 200 shares of capital stock were authorized to be issued by the debtor, John Malakoff issued 316 such shares.

16. At no time between August 7, 1951 and September 28, 1953, both dates inclusive, were any dividends to the legal or beneficial holders of the debtor's common stock declared or authorized by the debtor or paid to such stockholders by the debtor with its own funds.

17. The so-called dividends received between August 7, 1951 and September 28, 1953, both dates inclusive, by the persons who acquired legal or beneficial interests in the debtor represented the return to them by John Malakoff individually, directly or indirectly, of moneys advanced by such persons, directly or indirectly, for or against their respective interests in the debtor.

[fol. 320] 18. As to the stock claim of Charles Kanter (certificates numbered 4, 71 and 72 for 40 shares):

a. Between April 10, 1951 and April 17, 1953 Charles Kanter transferred cash and valuable equities totalling $20,800 for an interest in the debtor.

b. Between September 1, 1951 and March 1953 Charles Kanter received back $3,800 in cash.

c. The net fair value of the investment in the debtor by stock claimant Charles Kanter is $17,000.

19. As to the stock claim of Morton Samet (certificate number 5 for 2 shares):

a. Between March 14, 1951 and April 10, 1951 Morton Samet transferred cash totalling $2,000 for an interest in the debtor.

b. Between September 1, 1951 and May 1, 1953 Morton Samet received back $700.14 in cash.

c. The net fair value of the investment in the debtor by stock claimant Morton Samet is $1,299.86.

20. As to the stock claim of Gertrude Silver Klein (certificate number 6 for 14 shares):

a. Between April 2, 1951 and November 15, 1952 Gertrude Silver Klein transferred cash and valuable equities totalling $14,000 for an interest in the debtor.

[fol. 321] b. Between September 1, 1951 and April 1, 1953 Gertrude Silver Klein received back $2,534.22 in cash.

c. The net fair value of the investment in the debtor by stock claimant Gertrude Silver Klein is $11,465.78.

21. As to the stock claim of Dorothy Holober Clark (certificate number 11 for 3 shares):

a. Between June 1, 1951 and the month of August 1952, Dorothy Holober Clark transferred cash totalling $3,000 for an interest in the debtor.

b. Between November 2, 1951 and May 1, 1953 Dorothy Holober Clark received back $768.40 in cash.

c. The net fair value of the investment in the debtor by stock claimant Dorothy Holober Clark is $2,231.60.

22. As to the stock claim of Barry Clark (certificate number 12 for 4 shares):

a. On August 1, 1951 Barry Clark transferred cash totalling $4,000 for an interest in the debtor.

[fol. 322] b. Between September 1, 1951 and April 1, 1953 Barry Clark received back $1,316.73 in cash.

c. The net fair value of the investment in the debtor by stock claimant Barry Clark is $2,683.27.

23. As to the stock claim of Harold Q. Masur (certificate number 13 for 4 shares):

a. Between August 1, 1951 and September 30, 1951 Harold Q. Masur transferred cash totalling $4,000 for an interest in the debtor.

b. Between October 1, 1951 and May 1953 Harold Q. Masur received back $1,333.40 in cash.

c. The net fair value of the investment in the debtor by stock claimant Harold Q. Masur is $2,666.60.

24. As to the stock claim of Louis Como (certificates numbered 7 and 42 for 6 shares):

a. Between August 1951 and March 1953 Louis Como transferred cash totalling $6,000 for an interest in the debtor.

b. Between September 1, 1951 and May 1, 1953 Louis Como received back $1,466.73 in cash.

[fol. 323] c. The net fair value of the investment in the debtor by stock claimant Louis Como is $4,533.27.

25. As to the stock claim of Frank Como (certificates numbered 9 and 41 for 6 shares):

a. Between August 1951 and January 1953 Frank Como transferred cash totalling $6,000 for an interest in the debtor.

b. Between September 1, 1951 and April 1, 1953 Frank Como received back $1,366.73 in cash.

c. The net fair value of the investment in the debtor by stock claimant Frank Como is $4,633.27.

26. As to the stock claim of Patsy Como (certificates numbered 37 and 38 for 8 shares):

a. Between January 1953 and March 1953 Patsy Como transferred cash totalling $8,000 for an interest in the debtor.

b. Between March 2, 1953 and May 1953 Patsy Como received back $326.66 in cash.

c. The net fair value of the investment in the debtor by stock claimant Patsy Como is $7,673.34.

27. As to the stock claim of Anne Bikales (certificate number 16 for 5 shares):

[fol. 324] a. On August 30, 1951 Anne Bikales transferred cash totalling $5,000 for an interest in the debtor.

b. Between October 1, 1951 and May 1, 1953 Anne Bikales received back $1,666.80 in cash.

c. The net fair value of the investment in the debtor by stock claimant Anne Bikales is $3,333.20.

28. As to the stock claim of Lawrence Treat (certificate number 17 for 2 shares):

a. On September 11, 1951 Lawrence Treat transferred cash totalling $2,000 for an interest in the debtor.

b. Between November 1951 and May 1953 Lawrence Treat received back $666.80 in cash.

c. The net fair value of the investment in the debtor by stock claimant Lawrence Treat is $1,333.20.

29. As to the stock claim of Dorothy Kane (certificate number 19 for 3 shares):

a. Between September 18, 1951 and November 2, 1951 Dorothy Kane transferred cash totalling $3,000 for an interest in the debtor.

[fol. 325] b. Between October 1, 1951 and May 1953 Dorothy Kane received back $950.01 in cash.

c. The net fair value of the investment in the debtor by stock claimant Dorothy Kane is $2,049.99.

30. As to the stock claim of Miriam Klein (certificate number 22 for 4 shares):

a. Between September 17, 1951 and February 1, 1953 Miriam Klein transferred cash and valuable equities totalling $3,350 for an interest in the debtor.

b. Between November 1, 1951 and April 30, 1953 Miriam Klein received back $566.68 in cash.

c. The net fair value of the investment in the debtor by stock claimant Miriam Klein is $2,783.32.

31. As to the stock claim of Ruth Spielholz (certificate number 21 for 3 shares):

a. Between September 19, 1951 and January 26, 1953 Ruth Spielholz transferred cash totalling $3,000 for an interest in the debtor.

b. Between October 1, 1951 and April 1, 1953 Ruth Spielholz received back $426.67 in cash.

[fol. 326] c. The net fair value of the investment in the debtor by stock claimant Ruth Spielholz is $2,573.33.

32. As to the stock claim of Mae Bluestone (certificate number 24 for 2 shares):

a. On October 31, 1951 Mae Bluestone transferred cash totalling $2,000 for an interest in the debtor.

b. Between December 1, 1951 and April 1, 1953 Mae Bluestone received back $566.78 in cash.

c. The net fair value of the investment in the debtor by stock claimant Mae Bluestone is $1,433.22.

33. As to the stock claim of Gussie Schwartz (certificate number 30 for 2 shares):

a. On January 14, 1953 Gussie Schwartz transferred cash totalling $2,000 for an interest in the debtor.

b. Between February 2, 1953 and April 1, 1953 Gussie Schwartz received back $83.35 in cash.

c. The net fair value of the investment in the debtor by stock claimant Gussie Schwartz is $1,916.65.

[fol. 327] 34. As to the stock claim of Harold B. Schwartz (certificate number 29 for 4 shares):

a. Between July 23, 1952 and January 14, 1953 Harold B. Schwartz transferred cash totalling $4,000 for an interest in the debtor.

b. Between August 1, 1952 and April 1, 1953 Harold B. Schwartz received back $308.37 in cash.

c. The net fair value of the investment in the debtor by stock claimant Harold B. Schwartz is $3,691.63.

35. As to the stock claim of Lazar Karapantso (certificate number 39 for 2 shares):

a. In December 1952 Lazar Karapantso transferred cash totalling $2,000 for an interest in the debtor.

b. Between January 1953 and May 1953 Lazar Karapantso received back $188.92 in cash.

c. The net fair value of the investment in the debtor by stock claimant Lazar Karapantso is $1,811.08.

36. As to the stock claim of Ernest Pollak (certificate number 31 for 9 shares):

[fol. 328] a. During the month of December 1952 Ernest Pollak transferred cash totalling $9,000 for an interest in the debtor.

b. Between February 2, 1953 and May 1, 1953 Ernest Pollak received back $600 in cash.

c. The net fair value of the investment in the debtor by stock claimant Ernest Pollak is $8,400.

37. As to the stock claim of H. Lawrence Laupheimer (certificate number 23 for 8 shares):

a. Between October 18, 1951 and February 3, 1953 H. Lawrence Laupheimer transferred cash and valuable equities totalling $7,750 for an interest in the debtor.

b. Between November 1, 1951 and April 1, 1953 H. Lawrence Laupheimer received back $1,794.45 in cash.

c. The net fair value of the investment in the debtor by stock claimant H. Lawrence Laupheimer is $5,955.55.

38. As to the stock claim of Arnold A. Weinstein (certificate number 18 for 7 shares):

a. On September 19, 1951 Arnold A. Weinstein transferred cash totalling $7,000 for an interest in the debtor.

[fol. 329] b. Between November 1, 1951 and May 1, 1953 Arnold A. Weinstein received back $2,216.54 in cash.

c. The net fair value of the investment in the debtor by stock claimant Arnold A. Weinstein is $4,783.46.

39. As to the stock claim of Aaron Fried (certificate number 25 for 3 shares):

a. Between December 7, 1951 and October 20, 1952 Aaron Fried transferred cash totalling $3,000 for an interest in the debtor.

b. Between January 2, 1952 and May 1, 1953 Aaron Fried received back $683.41 in cash.

c. The net fair value of the investment in the debtor by stock claimant Aaron Fried is $2,316.59.

40. As to the stock claim of George Bond (certificate number 48 for 1 share):

a. On February 27, 1953 George Bond transferred cash totalling $1,000 for an interest in the debtor.

b. Between April 1, 1953 and May 1, 1953 George Bond received back $33.34 in cash.

[fol. 330] c. The net fair value of the investment in the debtor by stock claimant George Bond is $966.66.

41. As to the stock claim of Tess J. Schwartz (certificate number 60 for 3 shares):

a. On March 17, 1953 Tess J. Schwartz transferred cash totalling $3,000 for an interest in the debtor.

b. The net fair value of the investment in the debtor by stock claimant Tess J. Schwartz is $3,000.

42. As to the stock claim of Cydney Grosman (certificate number 61 for 2 shares):

a. On March 25, 1953 Cydney Grosman transferred cash totalling $2,000 for an interest in the debtor.

b. Between April 1953 and June 1953 Cydney Grosman received back $72.22 in cash.

c. The net fair value of the investment in the debtor by stock claimant Cydney Grosman is $1,927.78.

43. As to the stock claim of Rose Kaplan (certificate number 40 for 1 share):

[fol. 331] a. On February 17, 1953 Rose Kaplan transferred cash totalling $1,000 for an interest in the debtor.

b. On about February 23, 1953 Rose Kaplan received back $16.67 in cash.

c. The net fair value of the investment in the debtor by stock claimant Rose Kaplan is $983.33.

44. As to the stock claim of Robert A. Noire (certificate number 58 for 5 shares):

a. On March 16, 1953 Robert A. Noire transferred cash totalling $5,000 for an interest in the debtor.

b. The net fair value of the investment in the debtor by stock claimant Robert A. Noire is $5,000.

45. As to the stock claim of Harry Forman (certificates numbered 59 and 73 for 10 shares):

a. Between March 20, 1953 and April 23, 1953 Harry Forman transferred cash totalling $10,500 for an interest in the debtor.

[fol. 332] b. On May 5, 1953 Harry Forman received back $500 in cash.

c. The net fair value of the investment in the debtor by stock claimant Harry Forman is $10,000.

46. As to the stock claim of Richard S. Hull (certificates numbered 8 and 62 for six shares):

a. Between August 25, 1951 and October 4, 1951 Richard S. Hull transferred cash totalling $3,600 for an interest in the debtor.

b. Between October 1, 1951 and May 1, 1953 Richard S. Hull received back $1,200 in cash.

c. The net fair value of the investment in the debtor by stock claimant Richard S. Hull is $2,400.

47. As to the stock claim of Herbert and Melvin Danciger (certificate number 74 for 11 shares):

a. On April 28, 1953 Herbert and Melvin Danciger transferred valuable equities totalling $10,946.97 for an interest in the debtor.

b. The net fair value of the investment in the debtor by stock claimants Herbert and Melvin Danciger is $10,946.97.

[fol. 333] 48. As to the stock claim of Lester Saul (certificate number 20 for 3 shares):

a. On September 21, 1951 Leslie Saul transferred cash totalling $3,000 for an interest in the debtor.

b. Between November 1951 and May 1953 Leslie Saul received back $950 in cash.

c. The net fair value of the investment in the debtor by stock claimant Leslie Saul is $2,050.

49. As to the stock claim of Jerome Fried (certificate number 15 for 3 shares):

a. Between August and September 1951 Jerome Fried transferred valuable equities totalling $2,000 for an interest in the debtor.

b. Between October 1, 1951 and April 1, 1953 Jerome Fried received back $633.46 in cash.

c. The net fair value of the investment in the debtor by stock claimant Jerome Fried is $1,366.54.

[fol. 334] 50. As to the stock claim of Seymour Forman (certificate number 49 for 15 shares):

a. Between August 28, 1952 and March 13, 1953 Seymour Forman transferred cash and valuable equities totalling $13,000 for an interest in the debtor.

b. The net fair value of the investment in the debtor by stock claimant Seymour Forman is $13,000.

51. As to the stock claim of Eskander Manoochehrian (certificates numbered 36 and 63 for 20 shares):

a. In January 1953 Eskander Manoochehrian transferred valuable equities totalling $11,395.25 for an interest in the debtor.

b. On May 1, 1953 Eskander Manoochehrian received back $177.78 in cash.

c. The net fair value of the investment in the debtor by stock claimant Eskander Manoochehrian is $11,217.47.

[fol. 335] 52. As to the stock claim of Ann Rosen (certificate number 27 for 6 shares):

a. Between December 20, 1951 and March 5, 1952 Ann Rosen transferred cash totalling $6,000 for an interest in the debtor.

b. Between January 2, 1952 and March 1953 Ann Rosen received back $1,569.43 in cash.

c. The net fair value of the investment in the debtor by stock claimant Ann Rosen is $4,430.57.

53. As to the stock claim of Frederick Katzenell (certificates numbered 51, 52, 53, 54, 55, 56 and 57 for 35 shares):

a. On September 4, 1951 Frederick Katzenell transferred valuable equities totalling $16,850 for an interest in the debtor.

b. Between November 1951 and May 1953 Frederick Katzenell received back $7,250 in cash.

c. The net fair value of the investment in the debtor by stock claimant Frederick Katzenell is $9,600.

[fol. 336]

Conclusions of Law

1. Each of the stock claimants herein is entitled to shares of stock in such proportion to all the stock to be issued to stock claimants as the net fair value of his or her investment in the debtor (as hereinafter tabulated) bears to the total investment in the debtor.

Name	*Amount*
Charles Kanter	$17,000.00
Morton Samet	1,299.86
Gertrude Klein	11,465.78
Dorothy Holober Clark	2,231.60
Barry Clark	2,683.27

Name	*Amount*
Harold Q. Masur	2,666.60
Louis Como	4,533.27
Frank Como	4,633.27
Patsy Como	7,673.34
Anne Bikales	3,333.20
Lawrence Treat	1,333.20
Dorothy Kane	2,049.99
Miriam Klein	2,783.32
Ruth Spielholz	2,573.33
Mae Bluestone	1,433.22
Gussie Schwartz	1,916.65
Harold B. Schwartz	3,691.63
Lazar Karapantso	1,811.08
Ernest Pollak	8,400.00
H. Lawrence Laupheimer	5,955.55
Arnold A. Weinstein	4,783.46
Aaron Fried	2,316.59
George Bond	966.66
Tess J. Schwartz	3,000.00
Cydney Grosman	1,927.78
Rose Kaplan	983.33
Robert A. Noire	5,000.00
Harry Forman	10,000.00
Richard S. Hull	2,400.00
Herbert and Melvin Danciger	10,946.97
Leslie Saul	2,050.00
Jerome Fried	1,366.54
Seymour Forman	13,000.00
Eskander Manoochehrian	11,217.47
Ann Rosen	4,430.57
Frederick Katzenell	9,600.00

[fol. 337] II. Any alternative claim interposed by a stock claimant herein for the return of any consideration given or paid for stock in the debtor should be disallowed and dismissed.

III. Objections by whomsoever filed in opposition to the stock claims dealt with by these findings and conclusions should be sustained to the extent indicated herein and otherwise overruled.

IV. Counterclaims by whomsoever filed against the stock claimants whose stock claims are herein dealt with for the recovery of consideration for the stock claimed should be disallowed and dismissed.

V. Stock claims herein dealt with should be subject to counterclaims by whomsoever filed, if any, when proved, other than those counterclaims which should be disallowed and dismissed as provided in the preceding paragraph.

Settle an order consistent herewith.

....., United States District Judge.

Dated: New York, New York, October 19, 1960.

[fol. 338] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

Findings of Fact and Conclusions of Law Dated November 7, 1960 and Filed November 23, 1960

[fol. 339] SUGARMAN, D.J.:

Discussion

After a hearing on June 14, 1960 the district court made its order from the bench (S.M. 10,534) imposing certain terms and conditions for the continuation of the debtor in possession and operation by it of its business and management of its property in this Chapter X reorganization proceeding.

The order, predicated upon sections 188 and 189 of the Bankruptcy Act, allowed the debtor to remain in possession and to continue to operate its business upon condition that

"(a) Jerome Fried will be discharged from the debtor's employ at once. (b) Arnold A. Weinstein, president of the debtor, shall have nothing further to do with the operation of its business and affairs, and management of its property. (c) No funds of the debtor shall be disbursed except on the counter signature of Martin H. Philip as treasurer, whose election is hereinafter confirmed. (d) Pending the approval by the court of the employment of a general manager of the debtor, Martin H. Philip shall supervise its affairs."

At the hearing on June 14, 1960 the district court also granted a motion filed on August 25, 1958 confirming an election of directors and officers of the debtor held on August 4, 1958.

[fol. 340] At that hearing on June 14, 1960 the district court refused to reopen a determination made five months before after a hearing on January 4, 1960 terminating the compensation of Weinstein and Fried for having, while fiduciaries, dealt in the debtor's stock. The district court denied an application by the debtor's counsel for a stay (S.M. 10,543).

On June 20, 1960 Weinstein and Fried appealed.

They seek review of the prohibition against their continuing to participate in the operation of the debtor's affairs, of the termination of their compensation decided on January 4, 1960, no order on which was settled by the district court, and of the approval, on which findings of fact and conclusions of law were filed on August 1, 1960, of the election of Martin J. Philip, one of the several officers and directors elected on August 4, 1958.

Appellants were granted a stay by the Court of Appeals, which entered its order on July 12, 1960, staying the "four terms and conditions specified in the District Court's order of June 14, 1960".

It is assumed that the respondents on the appeal requested that the Court of Appeals remand the matter to the district court to make "further findings of fact and [fol. 341] conclusions of law". Instead, the district court was granted leave without formal remand to make such findings and conclusions if it so desired.

Inasmuch as the district court order of June 14, 1960 is predicated upon sections 188 and 189 of the Bankruptcy Act, as aforesaid, it granted relief not specifically sought by any party to the proceeding and said order was made *sua sponte* by the district court. The relief ordered was an alternative to a welter of applications, some of which in some respects overlapped others, then pending before the court. It is believed that findings and conclusions will clarify upon the review on appeal what the district court did on June 14, 1960 and they will for that reason be set forth *infra*.

To make the district court's reasons for the order of June 14, 1960 better understood, an analysis of the motions pending before it on June 14, 1960 is appropriate. It is presented as a preface to the findings of fact and conclusions of law.

Inceptively, however, the district court deals with the suggestion by the Court of Appeals that the district court consider the appointment of a trustee under section 159 [fol. 342] of the Bankruptcy Act. It did consider that alternative and abandoned it in the belief that the best interests of the creditors and stockholders would not be served by the appointment of a trustee at this late stage of the proceeding. The reorganization attempted herein is intended in the main to determine the interests of various stock claimants to the common stock of the debtor, a Pennsylvania corporation, operating a farmers' market in Nazareth, Pennsylvania.

Without going into detail, it is briefly recited that one John Malakoff, now deceased, was the entrepreneur who set up the debtor, acquired its property and sold interests therein. Although only 200 shares of stock were authorized by the debtor's charter, Malakoff undertook to distribute 316 shares to 41 claimants. The claims of a group of stockholders, colloquially known as the "Margolis group", were disallowed by a referee in bankruptcy on October 9, 1957, to whom the entire contest of stock interests was originally referred on January 5, 1955. That referee's decision is still awaiting the district court's review. The Margolis interests represented 54 shares claimed by 5 claimants. On March 20, 1958 the district court recalled from the referee

the determination of the balance of the stock interest claims [fol. 343] and tried them all itself over a period of approximately 86 trial days between May 19, 1958 and May 7, 1959. On October 19, 1960, it made its findings and conclusions as to the stock interests in the debtor of the remaining 36 claimants with respect to the balance of 262 shares claimed by them.

Knowing, on June 14, 1960, that within a relatively short period of time the review of the referee's decision on the Margolis stock interests and the court's decision as to the balance of the stock interests would be resolved the district court felt that no gainful purpose could be achieved by appointing a trustee after almost seven years of management by the debtor in possession but that such appointment would saddle the debtor with needless additional expense and in all probability compound an already complicated condition. Thus no trustee has as yet been appointed, although an examiner was appointed pursuant to section 168 of the Bankruptcy Act and has served as such since October 3, 1956.

Reverting to the discussion of what confronted the district court on June 14, 1960 when it conditioned the debtor's continued possession and operation of its business upon the four terms aforesaid, the following appears to be the record:

[fol. 344] On September 28, 1953, a petition was filed under Chapter X of the Bankruptcy Act for the debtor's reorganization. Judge Holtzoff, then sitting in the Southern District of New York, to whom the said petition was referred, made an order permitting the debtor to remain in possession and it has been in possession since.

During the course of the ensuing proceedings certain disputes arose between the management of the debtor and a group of alleged shareholders, colloquially referred to as the "Rehrig group", stemming from the alleged refusal of the management of the debtor to give Rehrig, a meat merchant in the market, fair consideration as to space, rental, etc. Control of the debtor was sought to be obtained by each side by an acquisition of the interests of various putative stockholders.

Many motions of different sorts were brought before the court at various times by the Rehrig interests. Those which are pertinent to June 14, 1960 are severally analyzed in schedules appended hereto which briefly recite the petitions presented, the relief sought and the disposition made. [fol. 345] The first of these petitions in point of time was a motion filed August 25, 1958, based upon a petition verified August 6, 1958, returnable September 8, 1958, that the court approve an election of directors and officers of the debtor held in Philadelphia on August 4, 1958. That motion was finally granted at the hearing on June 14, 1960 (S.M. 10,536). Findings of fact and conclusions of law in support of that order were made on August 1, 1960. The district court's reasons for delay in deciding this and other pending applications and for finally undertaking to decide them on June 14, 1960 are set forth in the minutes of the hearing of that date (S.M. 10,490 and 10,532).

The next motion in part before the court on June 14, 1960 was one brought on by an order to show cause granted March 16, 1959 on a petition verified March 13, 1959, originally returnable March 23, 1959. That application sought relief under section 249 of the Bankruptcy Act. The details as to the two branches of relief sought, the disposition made and the history of that petition are briefly set forth in the appended schedule dealing with that petition. It is pointed out, however, that the first branch (A) of the March 13, 1959 petition was, on January 4, 1960, ruled upon when a decision was made that the compensation of [fol. 346] Weinstein and Fried *in futuro* be terminated for their having, as fiduciaries, dealt in the stock of the debtor.

It was directed that an order be settled on that decision and one was submitted but its signing was held in abeyance because no substitute management was then immediately available and the district court expected that upon the resolution of the stock claimants' interests new management could be selected by the stockholders. Hence the referee was instructed to continue to countersign Weinstein's and Fried's salary checks until an order was settled. He continued to do so until the order of June 14, 1960 ending Weinstein's and Fried's management of the debtor. Although the Court of Appeals stayed the district court's

order disassociating Weinstein and Fried from participation in the debtor's management and they have continued to participate therein since the stay was granted, they have not drawn any salary since June 14, 1960.

As appears from the notations at the foot of the column headed "Remarks" on the schedule dealing with the March 13, 1959 petition, Weinstein's attempt on June 14, 1960 to reopen and have reconsidered the ruling of January 4, 1960 and to interpose an additional defense thereto, were denied by the district court (S.M. 10,485, 10,488 and 10,526). [fol. 347] It may also be noted from the said schedule that there was also before the court on June 14, 1960 the resolution of the second branch (B) of the March 13, 1959 petition upon which decision had been reserved on January 28, 1960.

The next motion in point of time which was before the court on June 14, 1960 was that brought on by order to show cause granted January 7, 1960 upon a petition verified January 5, 1960, originally returnable January 18, 1960. The first branch (A) of this application sought the removal of Weinstein, Laupheimer and Fried as officers, directors and general manager, as the case might be, of the debtor, for malfeasance in office. The basis of the malfeasance was originally sixfold, i.e., (1) their having traded in the debtor's stock while fiduciaries (which it should be noted was the same basis as supported the earlier petition of March 13, 1959); (2) the diversion or embezzlement of the debtor's property; (3) the unauthorized paving of the debtor's parking lot (which had subsequently been approved by the district court); (4) the unauthorized borrowing by the debtor of $30,000 from Carty (which has subsequently been approved by the district court and affirmed by the Court of Appeals [280 F.2d 891, July 18, 1960]); (5) the unauthorized construction of an office at [fol. 348] the debtor's market (which had subsequently been approved by the district court); and (6) the improper solication of the acceptance of a plan (which was withdrawn at the hearing on January 28, 1960).

As appears from the notation on the schedule dealing with the January 5, 1960 petition the branch thereof de-

nominated (B) was withdrawn by the petitioner and decision was reserved on January 28, 1960 on the branch designated (A) so that said branch (A) was before the court for final resolution on June 14, 1960.

Another matter before the court on June 14, 1960 was an order to show cause also granted on January 7, 1960 but upon a petition verified January 6, 1960. As appears by the appended schedule dealing with that motion, it was originally adjourned sine die on January 25, 1960, restored for consideration on June 14, 1960, then set down for hearing on September 26, 1960, at which time the respondents were given leave to interpose answers, etc. and the matter came on for further hearing on November 2, 1960.

As will appear from the foregoing and from the schedules of the various motions brought on by the Rehrig interests, decision was reserved on January 28, 1960 on a number of matters which were again before the district court on June [fol. 349] 14, 1960 by virtue of the district court having granted a new order to show cause on May 31, 1960 upon a petition verified May 27, 1960, returnable June 14, 1960, that cause be shown why the matters then pending and unresolved should not be forthwith determined.

As the schedule appended, dealing with the petition of May 27, 1960 shows, the district court: (A)(1) refused to disturb its order of January 4, 1960 terminating Weinstein's and Fried's compensation for having violated section 249 of the Bankruptcy Act by having dealt in the stock of the debtor while fiduciaries of the debtor, (2) refused, despite their violation of section 249 of the Bankruptcy Act, to direct them to return to the debtor prior compensation and reimbursed expenses received by them from the debtor; (B)(1)(a) adjourned the application for the removal of Laupheimer as secretary-treasurer of the debtor because by the simultaneous approval of the elections held on August 6, 1958 Laupheimer ceased to be the secretary-treasurer of the debtor, (b) held that it lacked power to remove Weinstein as president and director of the debtor, (c) granted the application for Fried's removal as general manager of the debtor, (d) *solely* because they had violated [fol. 350] section 249 of the Bankruptcy Act by trading in the debtor's stock and upon no other basis, directed that

Weinstein and Fried no longer have any voice in the management of the debtor's affairs as a condition of the debtor remaining in possession, (2)(a) limited the basis of the termination of compensation and reimbursed expenses to Weinstein and Fried to the first of the alleged bases of misconduct, to wit, their having traded in the stock of the debtor while fiduciaries of the debtor in violation of section 249 of the Bankruptcy Act, (b) denied recoupment of past compensation and reimbursed expenses upon any alleged basis; (C) set for hearing on September 26, 1960 (later adjourned to November 2, 1960) that portion of the petition of May 27, 1960 as addressed itself to the petition of January 6, 1960 that dealt with a lease between the debtor and Nazareth Enterprises, Inc. Although the petition of January 6, 1960, as will appear from the schedule thereon, was adjourned sine die at the hearing on January 25, 1960 and restored on June 14, 1960 for hearing, a new petition was filed on June 30, 1960 seeking the same relief as (B) in the petition of January 6, 1960 but against Weinstein and Fried and the same relief as (C) in the petition of January 6, 1960 but against Weinstein, Fried and Nazareth Enterprises, Inc. No schedule thereon is in- [fol. 351] corporated herein because the new show cause order came into being subsequent to June 14, 1960, the crucial day so far as the present discussion is concerned; (D) granted the petition of August 6, 1958 approving the election of directors and officers of the debtor as set forth in the schedule dealing with that petition.

In residue, therefore, it would appear that only three determinations resulted on June 14, 1960. First, the approval of the election of the debtor's officers and directors held on August 4, 1958, from part of which appeal has been taken; second, the denial of Weinstein's application to reopen the proceedings initiated by the petition of March 13, 1959, resulting in the termination of his and Fried's future compensation on January 4, 1960 for violation of section 249 of the Bankruptcy Act; and, third, making the debtor's continued possession conditioned upon Weinstein's and Fried's disassociation from the management of its affairs solely because they, as fiduciaries, violated section 249 of the Bankruptcy Act by dealing in the debtor's stock.

Based upon the forgoing discussion the district court now makes such additional findings of fact and conclusions of law as are deemed necessary.

[fol. 352]

As to the approval of the election of officers and directors on August 4, 1958

Adequate findings of fact and conclusions of law were made and filed on August 1, 1960.

As to the refusal of the district court to reconsider its termination of the compensation of Weinstein and Fried

1. The district court's memorandum decision filed January 4, 1960, in which the referee's dismissal of the proceeding brought under section 249 of the Bankruptcy Act was disapproved, adequately states the pertinent facts and law sustaining the decision that compensation cease *in futuro*.

2. No findings of fact or conclusions of law are appropriate as to the district court's exercise of its discretion in denying a reconsideration of the decision of January 4, 1960 terminating Weinstein's and Fried's compensation.

As to the continuation of the debtor's possession being predicated upon the disassociation of Weinstein and Fried from the debtor's management

Findings of Fact

1. Alternate management of the debtor became available by the approval of the election of debtor's officers and [fol. 353] directors held on August 4, 1958.

2. Weinstein and Fried as president and general manager of the debtor were fiduciaries of the debtor.

3. During their tenure as such and during the Chapter X reorganization proceeding they dealt in the debtor's stock.

4. The debtor's best interests require that it not be managed by persons serving without compensation.

Conclusions of Law

1. The court lacked power to remove Weinstein as president of the debtor.

2. For having traded in debtor's stock as aforesaid Weinstein's and Fried's management of the debtor should cease.

3. The debtor's continued possession should be allowed only on condition that Weinstein and Fried have no further voice in its management.

Sidney Sugarman, United States District Judge.

Dated: New York, New York, November 7, 1960.*

[fol. 354] * At the hearing which commenced on November 2, 1960, addressed to the petition for cancellation or rejection of the lease to the debtor's race track now held by Nazareth Enterprises, Inc., and for an accounting initiated by the petition of January 6, 1960, the appellants Weinstein and Fried requested that the court withhold filing the foregoing document because the time in which to perfect their appeal began running from the date of such filing and a hardship would be imposed upon them if the findings and conclusions were filed while they were thus engaged.

DATE OF NOTICE OF MOTION	Undated - Filed August 25, 1958
BASED UPON THE PETITION VERIFIED	August 6, 1958
RETURNABLE	September 8, 1958

RELIEF SOUGHT	DISPOSITION	REMARKS
That the court approve an election of directors and officers of the debtor held in Philadelphia, Pa. on August 4, 1958.	Granted on June 14, 1960 at a hearing thereon (S.M. 10,536). Findings of fact and conclusions of law in support of the order made from the bench on June 14, 1960 filed August 1, 1960.	The court's reasons for the delay in deciding this application are set forth at the hearing on June 14, 1960 (S.M. 10,490 and 10,532).

[fol. 356]

Petition Verified March 13, 1959

DATE OF THE ORDER TO SHOW CAUSE	March 16, 1959
BASED UPON THE PETITION VERIFIED	March 13, 1959
RETURNABLE	March 23, 1959

RELIEF SOUGHT	DISPOSITION	REMARKS
(A) - That hereafter in this proceeding no compensation or reimbursement of expenses be allowed or paid to Weinstein, Laupheimer, Fried or Nazareth Enterprises, Inc. or any of them pursuant to § 249 of the Bankruptcy Act. (B) - That Weinstein, Laupheimer, Fried and Nazareth Enterprises, Inc. and each of them account to this court for all compensation and reimbursement of expenses received by them from the debtor for the period from and after September 28, 1953, and that Weinstein, Laupheimer, Fried and Nazareth Enterprises, Inc. and each of them, restore to the debtor, and that the debtor recoup from each of them, all such compensation and reimbursement, pursuant to § 249 of the Bankruptcy Act.	As to (A) - at a hearing on January 4 (see adjoining column headed "Remarks") a decision was made terminating the future compensation of Weinstein and Fried, the prayer for such relief against Laupheimer having been previously withdrawn by petitioner (S.M. 8,624). As to (B) - This branch was adjourned for hearing to January 28, 1960. Consolidated with "removal" branch of January 5, 1960 petition (cf. schedule thereon infra) and decision reserved on January 28, 1960. (Cf. "Disposition" column on Schedule of May 27, 1960 petition.)	On March 20, 1959 Weinstein filed an affidavit in opposition to the petition which prayed that the petition be dismissed and that the stock purchase of the affiant be approved. On April 17, 1959 an order to show cause was granted Weinstein, returnable April 27, 1959 why the petition of March 13, 1959 should not be dismissed under F.R.Civ.P. 12(b) and if dismissal be denied allowing Weinstein additional time in which to answer the petition of March 13, 1959. On June 12, 1959 an order was entered referring the original petition of March 13, 1959 and cross motion of April 17, 1959 to Referee Herzog to hear and report pursuant to § 117 of the Bankruptcy Act. On June 19, 1959 the reference was transferred to Referee Joyce who reported on November 5, 1959 recommending dismissal of the original petition of March 13, 1959. At a hearing on the Referee's report on December 21, 1959 Weinstein and Fried were directed to file answers to the original petition which they subsequently did. A further hearing on the Referee's report was held on January 4, 1960 at which the action was taken as set forth in the middle column of this schedule headed "Disposition". Although settlement of an order was directed and one was subsequently submitted its signing was held in abeyance because (1) no other management was then available and (2) it was expected that with the resolution of the stock interest claims new management could be chosen. Accordingly, the Referee was directed to continue to countersign Weinstein's and Fried's salary checks until the matter reserved for the January 18, 1960 hearing was resolved. On June 9, 1960 an order to show cause, returnable June 14, 1960, was granted Weinstein, on his affidavit of June 8, 1960, why the termination of future compensation ordered on January 4, 1960 should not be reopened and reconsidered. The motion was denied on June 14, 1960 (S.M. 10,485). The original decision was adhered to on June 14, 1960 (S.M. 10,526). Also an oral motion by Weinstein at the June 14, 1960 hearing (S.M. 10,485) to interpose an additional defense of estoppel to the petition of March 13, 1959 was denied (S.M. 10,488).

[fol. 357]

PETITION VERIFIED JANUARY 5, 1960

DATE OF THE ORDER TO SHOW CAUSE	January 7, 1960
BASED UPON THE PETITION VERIFIED	January 5, 1960
RETURNABLE	January 1 , 1960

RELIEF SOUGHT	DISPOSITION	REMARKS
(A) - That Weinstein and Laupheimer be removed as President and Secretary-Treasurer respectively and as Directors and that Fried be removed as General Manager of the debtor for malfeasance, to wit: having traded in debtor's stock; diversion or embezzlement of the debtor's property; unauthorized paving of debtor's parking lot; unauthorized borrowing by debtor of $30,000 from Carty; unauthorized construction of an office at debtor's market; improper solicitation of acceptance of a plan.	(A) - Consolidated for hearing with "recoupment" branch of March 13, 1959 petition. Decision reserved on January 28, 1960. (Cf. "Disposition" column on Schedule of May 27, 1960 petition.) At the hearing on January 28, 1960 petitioner withdrew the "improper solicitation" branch of his petition.	Note that this order was procured during the period between the January 5, 1960 hearing, when the termination of future compensation of Weinstein and Fried had been ordered and recoupment under the March 13, 1959 petition under § 24[illegible] of the Bankruptcy Act had been adjourned to January 1[illegible], 1960. Weinstein and Fried filed answers to this January 5, 1960 petition on January 18 and 19 respectively and Laupheimer adopted Weinstein's answer as his at the hearing (S.M. 9,868). A consolidated hearing was held from January 25 through 2[illegible], 1960 on the adjourned "recoupment" (A) branch of the petition of March 13, 1959 and on the "removal" (A) branch of the January 5, 1960 petition (adjoining column headed "Relief Sought"). The court's reasons for the delay in deciding this application are set forth at the hearing on June 14, 1960 (S.M. 10,490 and 10,532).
(B) - That Weinstein, Fried and Nazareth Enterprises, Inc. account for compensation and reimbursement of expenses received by them from the debtor and that they restore all such compensation and reimbursements.	(B) - Withdrawn by petitioner at hearing on January 25, 1960 (S.M. 9,[illegible]44).	

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fol. 358]

PETITION VERIFIED JANUARY 6, 1960

PETITION VERIFIED JANUARY 6, 1960.

DATE OF THE ORDER TO SHOW CAUSE	January 7, 1960
BASED UPON THE PETITION VERIFIED	January 6, 1960
RETURNABLE	January 18, 1960

RELIEF SOUGHT	DISPOSITION	REMARKS
(A) - That a lease dated August 8, 1952 between the debtor, as lessor and one Sherman, as lessee, assigned by Sherman to Nazareth Enterprises, Inc. be cancelled and rejected. (B) - That Jerome Fried and Nazareth Enterprises, Inc. account for monies received from conducting racing at the debtor's property and from James LaGrotte or J. & J. Foods, Inc. (C) - That debtor have judgment against Fried and Nazareth Enterprises, Inc. for any amounts found due under the accounting.	At the hearing on January 25, 1960 this entire motion was adjourned sine die (S.M. 9,955) to await decision of other matters (cf. appended schedules dealing with January 5, 1960 petition and March 13, 1959 petition) upon which decision was reserved on January 28, 1960. On June 14, 1960 this motion was restored for hearing on September 26, 1960. On September 26, 1960 the hearing was adjourned to November 2, 1960.	Note that this order was procured during the period between the January 4, 1960 hearing when the termination of future compensation of Weinstein and Fried had been ordered and recoupment under the March 13, 1959 petition under § 249 of the Bankruptcy Act had been adjourned to January 18, 1960. Note further that this show cause order was granted the same day (January 7) returnable the same day (January 18) as the one seeking the removal of Weinstein, Laupheimer and Fried, as officers, directors and general manager of the debtor and an accounting and restoration to the debtor by Weinstein, Fried and Nazareth Enterprises, Inc. of compensation and reimbursed expenses received by them from the debtor.

[fol. 359]

Petition Verified May 27, 1960

DATE OF THE ORDER TO SHOW CAUSE	May 31, 1960
BASED UPON THE PETITION VERIFIED	May 27, 1960
RETURNABLE	June 14, 1960

RELIEF SOUGHT	DISPOSITION	REMARKS
That petitions then pending, i.e.,	At the hearing on June 14, 1960:	
(A) Petition of March 13, 1959 for termination and recoupment of compensation pursuant to § 249 of the Bankruptcy Act;	(A) 1 - Termination of compensation for violation of § 249 of Bankruptcy Act had been granted on January 4, 1960. 2 - Recoupment of compensation and reimbursed expenses for violation of § 249 of Bankruptcy Act denied (S.M. 10,533).	
(B) Petition of January 5, 1960 for removal of President, Secretary-Treasurer, Directors and General Manager of the debtor for misconduct in office	(B) 1a - So much as sought removal of Laupheimer as Secretary-Treasurer and Director of debtor for misconduct was adjourned because his tenure as such ended upon the granting (infra) of the petition of August 6, 1960 approving an election of other directors and officers of the debtor. b - As to so much as sought removal of Weinstein as President and Director of debtor for misconduct the court held it lacked the power to do so. c - As to so much as sought removal of Fried as General Manager of debtor for misconduct the court granted the application. d - But solely because Weinstein and Fried had, while fiduciaries, dealt in debtor's stock, in violation of § 249 of the Bankruptcy Act. The	
	debtor was allowed to remain in possession (§ 188 Bankruptcy Act) upon conditions that "(a) Jerome Fried will be discharged from the debtor's employ at once. (b) Arnold A. Weinstein, president of the debtor, shall have nothing further to do with the operation of its business and affairs, and management of its property. (c) No funds of the debtor shall be disbursed except on the counter-signature of Martin H. Philip as treasurer, whose election is hereinafter confirmed. (d) Pending the approval by the court of the employment of a general manager of the debtor, Martin H. Philip shall supervise its affairs."	
and for termination and recoupment of compensation;	2a - As to so much as sought termination of compensation and reimbursed expenses for misconduct, it was held on June 14, 1960 that anything beyond violation of § 249 of the Bankruptcy Act was moot because of the termination of compensation ordered on January 4, 1960 for that violation. b - So much as sought recoupment of compensation and reimbursed expenses for any alleged misconduct was at this hearing denied.	
(C) Petition of January 6, 1960 for cancellation of lease held by Nazareth Enterprises, Inc. and for accounting thereon and for judgment on the accounting and	(C) Set for hearing on September 26, 1960.	
(D) Petition of August 6, 1960 for approval of election of directors and officers of the debtor;	(D) Granted (S.M. 10,536 et seq.).	
be granted.		

[fol. 360] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

NOTICE OF SETTLEMENT—Filed December 9, 1960

Sirs:

Please Take Notice that the within Order Resolving Objections to Proofs of Stock Interests will be presented for settlement and signature herein to the Honorable Sidney Sugarman, one of the Judges of the within named Court, at the office of the Clerk of this Court, Room 601, United States Courthouse, Foley Square, New York, New York, on the 5th day of December, 1960, at 10:30 A.M.

Dated: New York, New York, November 25, 1960.

Charles Seligson, Examiner, 350 Fifth Avenue, New York 1, New York.

To:

Alex Rosen, Esq., Attorney for Debtor and Debtor in Possession, 225 Broadway, New York 7, New York.

Arnold Weinstein, Esq., 225 Broadway, New York 7, New York.

[fol. 361] Melvin L. Robbins, Esq., Attorney for Irving J. Wolf, Richard Hull, et al., 9 East 40th Street, New York 16, New York.

Benjamin Margolis, Esq., Attorney for Ida Mae Margolis, Sarah Kason, Bernard Unger and William McK Schongut, 271 North Avenue, New Rochelle, New York.

Jerome Fried, c/o Nazareth Fairgrounds & Farmers Market Inc., Post Office Box 293, Nazareth, Pennsylvania.

Louis Patur, Esq., Attorney for Seymour Forman, 11 Park Place, New York, New York.

Leonard Franklin, Esq., Attorney for Herbert & Melvin Danciger, 19 East 53rd Street, New York, New York.

Richard Hull, Esq., Attorney for Ernest Pollak, 41 Longview Road, Port Washington, L. I., New York.

Sam Lipson, Esq., Attorney for Jerome Fried and Nazareth Enterprises, 10 East 40th Street, New York 16, New York.

Meyer Kraushaar, Esq., Attorney for Aaron Fried, 42 Broadway, New York 4, New York.

Herman R. Agins, Esq., Attorney for Morton Samet, 285 Madison Avenue, New York 17, New York.

Harold Q. Masur, Esq., Attorney for Lawrence Treat, 520 East 20th Street, New York, New York.

[fol. 362] Bernard Buchwald, Esq., Attorney for Dorothy Holober Clark, Barry Clark, Harold Q. Masur, Gussie Schwartz, Harold B. Schwartz, George Bond, Tess J. Schwartz, Cydney Grosman and Lazar Karapontso, 16 West 46th Street, New York, New York.

Michael Berman, Esq., Attorney for Louis Como, Frank Como and Patsy Como, 37 Wall Street, New York 5, New York.

Maurice Harbater, Esq., Attorney for Charles Kanter, 373 West 52nd Street, New York, New York.

Jacob Weiswasser, Esq., Attorney for Anne Bikales and Mae Bluestone, 261 Broadway, New York 7, New York.

Gertrude Klein, 280 Collins Avenue, Mt. Vernon, New York.

Miriam Klein, c/o Gertrude Klein, 280 Collins Avenue, Mt. Vernon, New York.

Ruth Spielholz, 12 South 15 Avenue, Mt. Vernon, New York.

H. Lawrence Laupheimer, 20 Fara Drive, Stamford, Connecticut.

Rose Kaplan, 15 Crary Avenue, Mt. Vernon, New York.

Robert A. Noire, 186 East 164th Street, Bronx, New York.

Harry Forman, 32-42 91st Street. Jackson Heights, L. I., New York.

Eskander Manoochehrian, Windsor Mansion, Hartsdale, New York.

[fol. 363]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

ORDER RESOLVING OBJECTIONS TO PROOFS OF STOCK INTERESTS—December 8, 1960

At New York, in said district, on the 8th day of December, 1960.

Nazareth Fairgrounds & Farmers Market, Inc., the above named debtor, having filed a petition for reorganization herein on the 28th day of September 1953; and the said debtor having been continued in possession of its property and authorized to operate its business and manage its property, pending the further order of this court; and said debtor being presently in possession of its property and presently operating its business and managing its property; and said debtor having been incorporated under the laws of the Commonwealth of Pennsylvania on or about the 7th day of August 1951, with an authorized capitalization of 200 shares of no par value common stock, and

[fol. 364] An order having been made herein on or about the 5th day of January 1955 providing for the filing of proofs of stock interests, as well as proofs of claims of creditors; and 41 proofs of stock interests having been filed herein for a total of 316 shares of the capital stock of said debtor, of which five proofs of stock interests for an aggregate of 54 shares of the capital stock of the debtor were filed by Benjamin Margolis, Ida Mae Margolis, Sarah Kason, Bernard Ungar and William McK Schongut (hereinafter referred to as the Margolis group); and objections having been filed by the debtor to the allowance of the proofs of stock interests of the Margolis group, and such

objections having been referred to a referee in bankruptcy herein to hear and determine, and said referee having determined that the said proofs of stock interests of the Margolis group should be disallowed in toto and having entered an order in accordance with such determination, and a petition to review having been filed by the Margolis group, and the court having reserved decision thereon, and

Objections having been filed by the debtor herein on or about the 6th day of November 1957 to the allowance of the remaining 36 proofs of stock interests for 262 shares of the capital stock of the debtor, which objections included affirmative defenses and counterclaims; and such counterclaims, except as to Richard Hull and Jerome Frigd, having sought generally the recovery of $1,000 per share from each claimant held entitled to a stock interest in the debtor; [fol. 365] and the counterclaims against Richard Hull having sought the recovery of $1,000 per share or such other balance as the court deemed proper, in the event such claimant was held to be a stockholder, and the recovery of $261,811.78 and an accounting for damages to the debtor resulting from claimant's breach of trust; and such counterclaims against Jerome Fried having sought the recovery of $1,000 per share or such other balance as the court deemed proper in the event such claimant was held to be a stockholder, and the recovery of $314,012.78 and an accounting for damages to the debtor resulting from the improper diversion of assets of the debtor to which claimant was a party and the cancellation of a certain lease with respect to the operation of automobile races on the premises of the debtor owned by claimant or by Nazareth Enterprises Inc., a corporation owned or controlled by claimant; and additional objections to the allowance of certain of the proofs of stock interests having been filed herein by Benjamin Margolis, and hearings on the said objections having been duly noticed, and such hearings on the said objections having extended over a period of approximately 86 days, commencing on or about the 19th day of May 1958 and terminating on or about the 7th day of May 1959, and all of the claimants having appeared at the said hearings in person or by attorney, and

An order having been entered herein on or about the 3rd day of October 1956, pursuant to Section 168 of the Bankruptcy Act, appointing Charles Seligson as Examiner to perform the duties imposed upon a trustee under Paragraph 1 through 5 of Section 167 of the said Act; and the [fol. 366] Examiner, at the request of the court, having participated in the hearings upon the objections to the allowance of the said proofs of stock interests; and the court having, on the 19th day of October 1960, made its Findings of Fact and Conclusions of Law on the objections to the allowance of all proofs of stock interests other than the proofs of stock interests of the Margolis group, and the court having concluded that counterclaims for the recovery of consideration for the shares of stock of the debtor claimed by each stock claimant should be disallowed and dismissed but that stock claims should be subject to any other kind of counterclaims.

Now, upon the proofs of stock interests (other than those of the Margolis group) filed herein pursuant to the order of this court of the 5th day of January 1955, the objections to the allowance of such proofs of stock interests filed herein by Nazareth Fairgrounds & Farmers Market, Inc., the above named debtor, and by and on behalf of the Margolis group, and upon all the proceedings had before me at the said hearings, including without limitation all testimony taken and exhibits received, and upon the Findings of Fact and Conclusions of Law of this court filed herein the 19th day of October 1960, and sufficient reason and good cause appearing to me therefor: it is

Found, Ordered, Adjudged and Decreed

[fol. 367] 1. That each of the stock claimants hereafter named is the owner of the capital of Nazareth Fairgrounds & Farmers Market, Inc., the debtor herein, in such proportion to the total capital of the debtor as the net value of the investment of each such stock claimant in the debtor (as hereinafter tabulated) bears to the total investment in the debtor, as herein or hereafter found and determined, and to that extent is deemed to be a stockholder of the debtor for all purposes in the within reorganization proceeding and is entitled to shares of stock of the debtor calculated on that basis:

Name	*Amount*
Charles Kanter	$17,000.00
Morton Samet	1,299.86
Gertrude Klein	11,465.78
Dorothy Holobef Clark	2,231.60
Barry Clark	2,683.27
Harold Q. Masur	2,666.60
Louis Como	4,533.27
Frank Como	4,633.27
Patsy Como	7,673.34
Anne Bikales	3,333.20
Lawrence Treat	1,333.20
Dorothy Kane	2,049.99
Miriam Klein	2,783.32
Ruth Spielholz	2,573.33
Mae Bluestone	1,433.22
Gussie Schwartz	1,916.65
Harold B. Schwartz	3,691.63
Lazar Karapantso	1,811.08
Ernest Pollak	8,400.00
H. Lawrence Laupheimer	5,955.55
Arnold A. Weinstein	4,783.46
Aaron Fried	2,316.59
George Bond	966.66
Tess J. Schwartz	3,000.00
Cydney Grosman	1,927.78
Rose Kaplan	983.33
Robert A. Noire	5,000.00
Harry Forman	10,000.00
Richard S. Hull	2,400.00
Herbert and Melvin Danciger	10,946.97
Leslie Saul	2,050.00
[fol. 368] Jerome Fried	1,366.54
Seymour Forman	13,000.00
Eskander Manoochehrian	11,217.47
Ann Rosen	4,430.57
Frederick Katzenell	9,600.00

2. That any alternative claim interposed or asserted by any of the said stock claimants herein for the return of all or any part of the consideration allegedly given or paid

for stock in the debtor be, and the same hereby is, denied and dismissed;

3. That any and all objections by whomsoever filed to the allowance of the said stock claims (dealt with by these Findings and Conclusions) be, and the same hereby are, sustained to the extent heretofore indicated and are otherwise overruled;

4. That any and all claims and counterclaims by or in behalf of the debtor, by whomsoever filed, against the stock claimants and their assignees, or any of them, whose stock claims are herein resolved, directed to the recovery, payment, call, or assessment of the consideration for the debtor's issuance or sale of the stock claimed by each such claimant or his assignee, or of the subscription price or purchase price of such stock, be, and the same hereby are, disallowed and dismissed;

5. That jurisdiction and decision are reserved with respect to any and all counterclaims by whomsoever filed against the stock claimants whose stock claims are herein resolved where such counterclaims are not directed to the recovery of the consideration for the stock claimed by each such claimant, and which counterclaims have not been disallowed and dismissed as provided in Paragraph 4 hereof, including without limitation the counterclaims for money damages and accountings against Richard Hull and Jerome Fried; and that nothing contained in this order shall be [fol. 369] construed to affect in any way the determination by this court, now reserved, of the allowance or disallowance of the proofs of stock interests of the Margolis group; and

6. That this court reserves full power and jurisdiction to make such further orders in the premises as it may deem necessary or appropriate.

Sidney Sugarman, United States District Judge.

[fol. 370] Affidavits of service by mail (omitted in printing).

[fol. 374]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In Proceedings for the Reorganization of a Corporation

No. 89669

IN THE MATTER

of

NAZARETH FAIRGROUNDS & FARMER'S MARKET, INC., Debtor.

DECISION—June 28, 1961

SUGARMAN, D. J.:

On the petition of Irving J. Wolf, as assignee of Charles Kanter and as agent and attorney-in-fact for Wilson D. Rehrig and Frederick Katzenell, verified January 6, 1960, the court on January 7, 1960 ordered Jerome Fried and Nazareth Enterprises, Inc. to show cause on January 18, 1960 why an order should not be entered

(A) that a certain lease dated August 18, 1952 between the debtor as lessor and one Joseph Sherman as lessee, assigned by the latter to Nazareth Enterprises, Inc. on April 28, 1953, be cancelled or rejected forthwith;

(B) that Jerome Fried and Nazareth Enterprises, Inc. account for all money and property received by them

(1) incident to their having conducted a racing enterprise on the property of the debtor, and

(2) from James LaGrotte or J & J Foods, Inc.;

(C) that the debtor have judgment against Jerome Fried and Nazareth Enterprises, Inc. for the amounts found due on the accounting.

[fol. 375] When the petition came on for hearing on January 25, 1960 it was adjourned *sine die*.

On May 31, 1960 an order to show cause, predicated upon the petition of Wolf, verified May 27, 1960, was granted reviving for hearing on June 14, 1960 the said application for cancellation or rejection of the lease and for accounting. On June 14, 1960 the matter was set for hearing on September 26, 1960. At the hearing on September 26, 1960 the petitioner filed an amended petition verified September 12, 1960, for cancellation or rejection of the lease and for an accounting, in which the prayer for relief was identical with that prayed for in the original petition of January 6, 1960.

At the hearing on September 26, 1960 the debtor in possession was afforded an opportunity by answer to the petition to join or oppose the application or take such other steps as it deemed appropriate.

Between the hearing on June 14 and the hearing on September 26, 1960, namely, on the first day of July, 1960, an order to show cause, based upon the petition of Irving J. Wolf, verified June 30, 1960, and returnable September 26, 1960 was granted. Under this order

(a) Arnold A. Weinstein and Jerome Fried were directed to show cause why an order should not be made that they and each of them account for all money and other property received by both or either of them and by Nazareth Enterprises, Inc. incident to the racing enterprise conducted by Jerome Fried and Nazareth Enterprises, Inc. on the debtor's property.

(b) that the debtor have judgment against Weinstein and Fried for the amounts found due upon that accounting, including unpaid rents found to be due from Nazareth Enterprises, Inc. to the debtor and amounts found to have been received by Nazareth Enterprises, Inc. and Jerome Fried from James LaGrotte and J & J Foods, Inc.

[fol. 376] At the hearing on September 26, 1960 the petitioner filed an amended petition, verified September 13, 1960, for accounting and surcharge, in which the prayer for relief is identical with that prayed for in the original petition of June 30, 1960.

At the hearing on September 26, 1960, after withdrawing from the amended petition verified September 13, 1960 (as

a basis for the relief sought in the order to show cause granted July 1, 1960) reference to a petition verified January 5, 1960 (S. M. 10,679) the petitioner stipulated that there be a consolidation for trial of the order to show cause granted January 7, 1960 with the order to show cause granted July 1, 1960, both to be predicated upon the petitioner's amended petition verified September 12, 1960, so that the total relief sought would be—

> "Cancellation and termination of the Nazareth Enterprises, Inc., lease; accounting under the Nazareth Enterprises, Inc., lease; accounting under the J & J Foods and LaGrotte transaction against Weinstein, as an officer of the debtor, Fried, as general manager of the debtor, Fried as an individual and Nazareth Enterprises, Inc." (S. M. 10,678)

The debtor, Arnold Weinstein, Jerome Fried and Nazareth Enterprises, Inc. having filed answers (the last two of which asserted a counterclaim against the debtor for the expenditure of money for repairs to the race track on the debtor's property which is the subject matter of the lease herein, to which counterclaim petitioner, but not the debtor, replied) the consolidated orders to show cause came on for hearing on November 2, 1960 and continued for ten trial days intermittently until November 22, 1960.

Preliminarily it becomes necessary for the court to dispose of the defenses pleaded by the respondents which do not go to the merits. Respondent Nazareth Enterprises, Inc. in its answer raises certain specific defenses, which are dealt with *in limine:*

[fol. 377] (1) That the petitioner failed to set forth a claim upon which relief can be granted. Sufficient has been developed in the hearing to warrant that this defense be and it is overruled.

(2) Petitioner has no standing to maintain this proceeding. I am satisfied that under §206 of the Bankruptcy Act [11 U. S. C. §606] the petitioner, without the necessity of court permission to intervene, has the right to bring this proceeding.

(3) Petitioners principal is not a stockholder of the debtor and the petition is premature. I have heretofore held that the petitioners principals have a financial interest in the debtor and I have specifically found that to be the fact. Accordingly, this defense is overruled.

(4) The court lacks jurisdiction to summarily determine rights under a lease antedating the Chapter X proceeding. While the instrument in question has all the earmarks of a lease, it is in essence no more than a license to operate automobile exhibitions on certain days on a limited portion of the debtor's property constituting the race track. The entire premises have at all times been in the possession or under the control of the debtor in possession and that was so when the reorganization petition was filed herein. Possession is the touchstone of summary jurisdiction and the debtor's possession at the date of the filing of the reorganization petition, vests this court with jurisdiction in this reorganization proceeding to determine the issues raised here concerning the validity of the "lease". *Thompson* v. *Magnolia Petroleum Co. et al.*, 309 U. S. 478 (1940). Jurisdiction over the subject matter draws to it jurisdiction to determine the rights of all persons who claim or assert any interest in the *res*. *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734 (1931); *In re Wilka*, 131 Fed. 1004 (N. D. Iowa 1904). It is therefore immaterial that Nazareth Enterprises, Inc. and Fried are both non-resi- [fol. 378] dents of the Southern District of New York. This defense is overruled.

(5) Petitioner and the debtor are barred from proceeding by a two-year limitation. Although pleaded in the answer, the respondent Nazareth Enterprises, Inc. does not touch upon this issue in its brief. In view of my finding *infra* that there was no fraud in the inception or the extension of the term of the agreement, it becomes moot whether the within proceeding is time barred under §11e of the Bankruptcy Act [11 U. S. C. §29(e)] or under the Pennsylvania or New York six-year statutes of limitations. However, as to the rental modification, treated with hereinafter, the action would be governed by the six-year statute of

either New York or Pennsylvania, and, as is found *infra*, that having taken place in 1956, the within proceeding is thereby not time barred.

(6) The debtor ratified the transactions referred to in paragraphs 4, 5, 6, 9, 10, 11, 16, 17 and 18 of the petition.

Paragraphs 4, 5 and 6 of the petition address themselves to the petitioner's contention that the "lease" was fraudulent in its inception. As will later appear I hold that petitioner has not borne his burden of establishing the alleged fraud, hence the alleged ratification by the debtor is of no moment.

Paragraphs 9, 10 and 11 of the petition address themselves to the unauthorized reduction in percentage rents. These paragraphs are treated together with paragraphs 16, 17 and 18 of the petition which deal with the alleged diversion of rents for the food concessions on automobile exhibition days.

In dealing therewith consideration is also given to the 11th, 12th, 13th and 14th separate and distinct defenses in respondent Nazareth Enterprises, Inc.'s answer, which, aside from the claimed ratification in this 6th defense, plead separate defenses to paragraphs 11, 16, 17, 18 and 19 of the petition.

[fol. 379]. As will be hereinafter indicated the court rejects the contention of respondent Nazareth Enterprises, Inc. that the modification of the rental payable by Nazareth Enterprises, Inc. to the debtor in possession, which the court finds occurred apparently in 1956, to be effective with the commencement of the 1957 racing season, was a transaction in the ordinary course of the business of the debtor in possession and valid without court approval. However, that aspect of the petition is of little moment because under the terms of the agreement in issue respondent Nazareth Enterprises, Inc. was required, once it elected to take over the food and drink concessions on automobile exhibition days, to pay 15% of the front-gate receipts. It must follow, therefore, regardless of the validity of the later modification, to an even lower percentage than the 12% provided in the agreement when the respondent Nazareth Enterprises, Inc. did not operate the food and drink concessions,

that the respondents Nazareth Enterprises, Inc. or Fried are accountable to the debtor in possession for the difference between the actual rental paid commencing with the 1955 racing season, when the Nazareth Enterprises, Inc. first took over the operation of the food and drink concessions and the 15% which it was required to pay in that contingency. It therefore follows that the debtor is entitled to receive from Nazareth Enterprises, Inc., for the period commencing with the 1955 racing season, the difference between what it paid and 15% of the front-gate receipts down to the present.

Without the court's approval, and solely on his own, without even consulting the other governing authorities of the debtor in possession, Weinstein, as debtor's president, had no power to accept for the racing seasons 1955 and 1956, once respondent Nazareth Enterprises, Inc., elected to operate the concessions on exhibition days, the smaller percentage (12%) provided for in the "lease" and as hereinabove and hereinafter set forth, the even further reduced percentage resulting from the so-called modification com- [fol. 380] mencing with the 1957 racing season. If Weinstein agreed without the court's permission to take only the 12% rental for the years 1955 and 1956, and if he agreed to take even a lower rental for any of the subsequent years, his agreement is not binding on the debtor in possession and there is nothing in the record to sustain the ratification which the respondent Nazareth Enterprises, Inc. asserts in its 6th defense; what could not be authorized by Weinstein in the first instance could not be ratified by the debtor without court approval.

(7) This defense in essence pleads laches on the part of the debtor in possession and the petitioner. Obviously, the estate of the debtor in possession cannot be prejudiced by any act or omission by the petitioner. Furthermore, if the respondent Nazareth Enterprises, Inc. changed its position, it did so at its own peril because as far back as November 8, 1957 it had notice that the debtor challenged the validity of the agreement in question when, in filing its objections to Jerome Fried's claim as a creditor it counterclaimed "That the lease owned by Jerome Fried,

or Nazareth Enterprises, Inc., the corporation in which said Jerome Fried owns all the stock, or controlling shares of stock, leasing a certain portion of the Debtor's premises for stock auto races, be cancelled and declared null and void". Decision on that counterclaim is still pending, having been reserved, together with certain creditors' claims, pending a final determination of the financial interest of the various so-called stockholders. It might also be noted that there was filed, on December 1, 1956 with Referee John E. Joyce, by Ida Mae Margolis *et al.*, a specific prayer that the "lease" in question be delivered up and cancelled and an accounting be had thereon from the time respondent Fried acquired the same to that time.

(8) and (9) This court lacks jurisdiction over respondent Nazareth Enterprises, Inc., a Pennsylvania corporation, because it is not located in the Southern District of [fol. 381] New York. If this defense is addressed to the court's jurisdiction to determine the rights of Nazareth Enterprises, Inc. under the "lease", it has already been disposed of in the treatment of the fourth defense. If, however, it is addressed to personal jurisdiction over Nazareth Enterprises, Inc., it is disposed of in the treatment of Fried's comparable defense, *infra*.

(10) The debtor and Nazareth Enterprises, Inc. modified the rentals under the lease. As appears *supra* in treating with this respondent's 6th defense and as will further appear hereinafter the claimed modification is rejected.

(11) The debtor benefited by the modification of the "lease". This defense must be rejected out of hand. It is obvious that if the debtor was entitled as hereinabove and hereinbelow held, to 15% of the front-gate, if it got any less, no matter how much it got over and above what it got the year before, it did not benefit.

(12) Respondent Nazareth Enterprises, Inc. had the right to sell prepared foods on "racing" days. This defense is valid and I so herein hold, *infra*.

(13) Respondent Nazareth Enterprises, Inc. allowed J & J and LaGrotte to pay rentals due it to the debtor in

1953 and 1954 to help the debtor's financial needs. The debtor was entitled to the rentals from the food concessions in 1953 and 1954 without any grace by the said respondent because during those years the said respondent chose not to exercise the food vending privilege and paid only 12% rental upon that election.

(14) Respondent Nazareth Enterprises, Inc. had the right to retain rentals from J & J and LaGrotte from food sales on "racing" days. This is a valid defense but concomitant with that right is the obligation as herein held to pay debtor in possession the full percentage of rental called for by the agreement.

* * * * * * *

[All Asterisks Appearing in this Decision are the Court's.]

[fol. 382] Fried in his answer adopts all of the defenses interposed by Nazareth Enterprises, Inc. The prior treatment of the defenses interposed by respondent Nazareth Enterprises, Inc., is of course applicable to respondent Fried where he pleads a defense by incorporation of that of his corporate co-respondent.

Fried adds the defense that the court lacks jurisdiction of his person because he is a Pennsylvania resident. This issue has already been resolved above in the treatment of the 9th defense of the respondent Nazareth Enterprises, Inc. insofar as it addresses itself to the court's jurisdiction to determine rights under the agreement.

However, if it is intended to go beyond that and challenge the court's power to direct the payment by respondents of the additional rental herein provided for, then the short answer is (1)(a) as to Fried he has been held to be a fiduciary of the debtor in possession and is therefore answerable to this court no matter where he may be found; (b) furthermore, Fried has waived any objection to the jurisdiction of this court by his actions in the proceeding, Bankruptcy Act §2a(7) [11 U. S. C. §11a(7)]; and (2) as to Nazareth Enterprises, Inc., it is indicated *infra* that the corporate shell is the alter ego of Fried and his answer-

ability is that of the corporation; *cf. May* v. *Henderson*, 268 U. S. 111 (1925).

• • • • • • •

The debtor in possession filed an answer in which it raised two affirmative defenses. The first challenges the right of the petitioner or his principals without court authorization to maintain or prosecute this proceeding. That has already been disposed of in treating with the 2nd defense of respondent Nazareth Enterprises, Inc. The second appears to urge that under §167(3) of the Bankruptcy Act [11 U. S. C. §567(3)] the examiner must first investigate and report to the court, whereupon the court must determine whether it will allow this proceeding. The [fol. 383] statute requires the examiner to "report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate". It is unnecessary for the examiner to make such report with respect to matters on which the debtor in possession has taken action, as in this case. It will be recalled that the debtor in possession has heretofore put in issue the validity of the lease to Nazareth Enterprises, Inc. and that matter is as yet unresolved. Moreover, the statute refers to causes of action available to the estate at the date of the filing of the reorganization petition and therefore would not cover any wrongdoing committed subsequent to the filing of the reorganization petition. Apart from these facts, however, certainly a recommendation by the examiner is not a condition precedent to the bringing of this proceeding by the petitioner who has as aforesaid been held to have the right to do so.

• • • • • • •

Respondent Arnold A. Weinstein interposed an answer to the petition for accounting and surcharge, which as above indicated became part of the ultimate issue tried. In that answer he made reference to orders to show cause granted on January 7, 1960, predicated upon petitions sworn to January 5 and January 6, 1960. Obviously any answer to the petition sworn to January 5, 1960 is of no moment in the instant proceeding. Only the petition of

January 6, 1960 is pertinent because that was the one superseded by the amended petition of September 12, 1960, which remained part of the consolidated issue now before the court.

Arnold Weinstein's answer contains only one defense which can be considered pertinent to this issue and that is the third defense of his answer, as verified September 12, 1960. In that defense he urges that the modification entered into between him and respondent Nazareth Enterprises, Inc. in the latter part of 1956 was for the debtor's [fol. 384] benefit and to its profit. In dealing with the answers of the other respondents, those arguments have already been rejected. However, Weinstein further as part of his third defense aforesaid alleges that he did not personally profit from the modification. The court so finds and as elsewhere herein appears denies petitioner any relief against respondent Weinstein.

* * * * * * * *

The respondents Nazareth Enterprises, Inc. and Fried's counterclaims are dismissed because they would arise only if the agreement were rejected or cancelled.

Although the petitioner filed a defense to the counterclaims of respondents Nazareth Enterprises, Inc. and Fried no treatment thereof is necessary because of the dismissal of the counterclaims.

* * * * * * *

The pleadings and the proof present these substantive issues for resolution:

1. The nature of the document involved.
2. Should the document be cancelled for fraud
   (a) prior to the Chapter X petition
      (i) in the inception of the document;
      (ii) in the extension of its term;
   (b) subsequent to the Chapter X petition?
3. Should the document be rejected as burdensome to the debtor in possession under §116(1) of the Bankruptcy Act [11 U. S. C. §516(1)]?

1. The Nature of the Document Involved.

Although throughout the pleadings, the testimony and the argument the document to which this consolidated proceeding is addressed is referred to as a "lease" and in [fol. 385] form it appears to have all of the attributes of a "lease", I hold it to be no more than the parties intended and acted upon it to be, namely, a license granted by the debtor to Sherman and his assignee Nazareth Enterprises, Inc. to run automobile races and events on the debtor's track at the debtor's property at such times as the debtor was not conducting market days, i.e., did not open its property to the public for the sale of merchandise and services by the debtor's concessionaires and tenants.

2. (a) Should the Document Be Cancelled for Fraud Prior to the Chapter X Petition

(i) in the inception of the document;

(ii) in the extension of its term?

It is my view that petitioner has failed to establish fraud, with the required degree of certainty, either in the inception or the extension of the document that would warrant its cancellation.

(i) Assuming, as petitioner contends, that respondent Fried was acting for both the Malakoff interests and as a secret partner of Sherman when the original letting was entered into, the terms of the document (on the basis of what was learned during the trial as to the usual terms of agreements of this kind) seem to be fair. Furthermore Fried obtained the ratification of the Malakoffs after he, on behalf of the then controlling interests, entered into the agreement between the debtor and Sherman. Standing by itself, Fried's dual capacity excited enough suspicion that cast upon him the burden, which as above indicated he sustained, of justifying the fairness of the arrangement under the then existing circumstances. The value of the race track privilege at the market in 1952 when the agreement was made was far less than the value of that privilege in 1960 because of what had been developed in the intervening years.

[fol. 386] (ii) I reject the petitioner's contention that the "lease" was fraudulently altered to effect an extension of the term of the "lease". While it is true that a photostat first came into evidence during the Fried creditor claim (Margolis Exhibit C), that appeared to have had the term extended in the pen and ink fill-in from either 1952 or 1953 to 1962, the later production of the original agreement (Debtor's Exhibit 2, in this proceeding) even under the improbable circumstances explaining its absence until that time, is persuasive that the original letting was for the ten-year period. His assignment of the agreement to respondent Nazareth Enterprises, Inc. on April 28, 1953, belies Sherman's testimony that the original document was for only one season or until a few months after the assignment in 1953.

2. (b) Should the Document be Cancelled for Fraud Subsequent to the Chapter X Proceeding?

Petitioner predicates this branch of the relief sought upon the contentions that

(i) Any "modification" of the agreement required prior approval by the Chapter X court;

(ii) The oral agreements among Fried, Weinstein, and LaGrotte were and are voidable under the Statute of Frauds, and effected a continuing fraud on the debtor;

(iii) The food concession rents during race track exhibitions belong to the debtor, not to respondents;

(iv) Under the agreement "gross admissions" include the "back-gate" receipts.

(i) I agree that the modification of the percentage as rental required prior approval by the Chapter X court. There is conflict in the record as to when this oral modifica- [fol. 387] tion took place between Weinstein and Fried. I accept the version that it became effective with the beginning of the 1957 season. I cannot at this time say whether I would or would not have approved the modification if it had then been submitted. I cannot say now whether I

might have been influenced by Fried's statement that he was prepared to abandon the whole enterprise unless he got relief. I cannot say now whether I would have approved the arrangement that contemplated a change in the food concession operation assuming it to be necessary [*cf.* 2(b)(ii) and (iii) *infra*] and a change in the rental, predicated upon the amount of purses.

In any event, I believe that the petition should be granted to the extent of requiring respondent, Nazareth Enterprises, Inc. and upon its default, respondent Fried, to pay rental at the rate of 15% for each of the years 1955 and subsequent thereto.

I do not believe that Weinstein can be held accountable for any loss of the income sustained by the debtor as a result of the rent modification made without the prior approval of the court. I believe that in doing so he thought he was acting in the best interests of the debtor in order to retain whatever rental was being realized from the automobile exhibitions and that he personally is not answerable for the failure to procure court approval inasmuch as he did not personally benefit financially in any respect whatsoever.

Fried, however, is in a different position, because he and Nazareth Enterprises, Inc. are in essence one and the same. When the modification of rental took place Fried was the general manager of the business of the debtor in possession; the corporate co-respondent wholly owned by him and his wife had a written agreement which he has insisted all along is binding upon the debtor as well as upon him; he was charged with knowledge that Weinstein lacked authority to make an oral modification of that agreement without prior court approval; and he and his corporate [fol. 388] co-respondent were the only beneficiaries in pocket of the modification.

The basis of the assessment against Nazareth Enterprises, Inc. and upon its default Fried, of the difference between the rental paid and the rental due beginning with the 1957 season is predicated solely upon the failure to obtain the court's approval, it being my opinion that so radical an alteration in the terms of the agreement was not that of the ordinary operation of the business allowed to the

debtor in possession without court approval, under the original order continuing it in possession and particularly when this agreement was between the debtor and its general manager, a fiduciary.

The requirement that respondent Nazareth Enterprises, Inc. also pay the difference between 15% and the rent paid for the earlier years of 1955 and 1956 is entirely aside from the modification which occurred effective in 1957. Respondent Nazareth Enterprises, Inc. undertook to operate the food and drink concessions on automobile exhibition days for the 1955 and 1956 seasons and having done so was obliged to pay debtor in possession 15% of the gross admissions during those two years.

(ii) and (iii) The provision in the third paragraph of the assigned agreement that the debtor was to receive 12% of the gross admissions except on those days when Nazareth Enterprises, Inc. operated the food concessions when the debtor was entitled to 15% of the gross admissions, implicitly allows Nazareth Enterprises, Inc. to determine whether it will operate the food concessions on automobile exhibition days. If it chooses so to do, it must pay the 15%. If not, its rent is 12%. It chose so to do and I reject the petitioner's technical argument that it had to physically operate the concessions itself. It had the right on any basis whatsoever to delegate the supplying of food and drink to anyone whom it chose. The only restriction imposed, if it availed itself of the privilege of operating the food concessions, was to increase its rental from 12% to 15%.
[fol. 389] I therefore believe that the petitioner has failed to establish fraud in the oral agreements regarding the food concessions on automobile exhibition days and in the assertion that because of that fraud the concession rents belonged to the debtor and not to respondent Nazareth Enterprises, Inc.

(iv) From the testimony I am satisfied that "gross admissions" do not include the back-gate receipts. However, the debtor in possession is accorded the right to alter the present practices at both the "front" and "back" gates on automobile exhibition days to assure that it is receiving proper rental under the agreement.

3. Should the document be rejected as burdensome to the debtor in possession under 116(1) of the Bankruptcy Act [11 U. S. C. 516(1)]?

While I agree that the court may authorize rejection in a proper case, I do not agree with the petitioner that it would be in the best interests of the debtor to now reject the agreement. Very little advantage would accrue to the debtor in possession (in the light of the surcharge of the difference in rental for the period commencing with the 1955 racing season) in having Marshman or Crist operate the automobile exhibitions. I am persuaded that the best interests of the debtor will be served by permitting respondent Nazareth Enterprises, Inc. to continue to operate, at least for the balance of the 1961 racing season, particularly because the 1961 racing season has now commenced, but more specifically because the proposals suggested by the petitioner or others do not appear to offer substantially enough, if anything, to warrant ousting respondent Nazareth Enterprises, Inc. from the operation it has been conducting for these many years.

The foregoing shall constitute the court's findings of fact and conclusions of law.

[fol. 390] The examiner is directed to settle an order, on notice, consistent herewith.

Dated: New York, New York, June 28, 1961.

Sidney Sugarman, United States District Judge.

[fol. 1]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Bankruptcy 89669

In the Matter

—of—

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.

Before:

HON. SIDNEY SUGARMAN,

District Judge.

Transcript of Testimony—New York, May 19, 1958

10.30 o'clock a.m.

APPEARANCES:

Rosen & Rosen, Esqs., Attorneys for Debtor; Alex L. Rosen, Esq., of Counsel.

Charles Seligson, Esq., Examiner, Charles Seligson, Esq., and David Mandel, Esq., of Counsel.

Melvin Lloyd Robbins, Esq., Attorney for Robert H. Davidson, Frederick Katzenell, Irving J. Wolf, Richard Hull, Ernest Pollak, Dorothy Kane, Ann Rosen and Wilson Rehrig.

Jacob Weiswasser, Esq., Attorney for Mae Bluestone and Alexander Fisher, as Assignee of Anna F. Bikalis.

[fol. 2] Herman R. Agins, Esq., Attorney for Blanche Waldman.

Nicholas Kohn, Esq., Attorney for Robert A. Noire.

Louis R. Patur, Esq., Attorney for Seymour Forman.

Solomon Gilbert, Esq., Attorney for Eskandar Manoochehrian; Sidney Bush, Esq., of Counsel.

Benjamin Margolis, Esq., Attorney for Benjamin Margolis, Ida May Margolis, Sarah Kason and Bernard L. Unger.

Jerome Fried, Esq., pro se and Aaron Fried.

Morton Samet, pro se.

Arnold A. Weinstein, pro se.

Milton Sanders, Esq., Attorney for Harry Forman.

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[fol. 69] Recross examination of
Mrs. Leslie Saul.

By Mr. Seligson:

Q. He just said that, "I want a thousand dollars a share for the stock in this corporation"?

A. And that he would issue stocks for it.

Q. And you agreed to buy three shares at a thousand dollars per share.

A. Yes, sir.

Q. Now, the letter, which is Claimant's Exhibit 5, states that you were to receive dividends at the rate of 20 per cent per annum, payable monthly.

A. That's right.

Q. And there have been introduced in evidence a number of checks that you received.

A. That's right.

Q. Now, can you tell us the total that you received from Mr. Malakoff, allegedly by way of dividends?

A. I don't know exactly in dollars and cents. They were $50 a month, about $50 a month.

Q. But are they all represented by the checks that have been offered in evidence today?

[fol. 70] A. I think so.

* * * * * * *

[fol. 119] Cross examination of
Edward Malakoff.

By Mr. Robbins:

Q. Mr. Malakoff, you said that Richard Realty Company conveyed the property to Kipling Realty Company. Who were the stockholders of Kipling Realty Company?

A. Same as Richard Realty Company.

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[fol. 120] The Court: Now, am I to understand that the stockholders of Kipling Realty Company were the partnership as such?

The Witness: That's right.

The Court: The stock in Kipling was issued to the partnership?

The Witness: Yes, your Honor.

The Court: All right.

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By Mr. Robbins:

Q. Mr. Malakoff, did Kipling Realty Company subsequently convey the property to Nazareth Fair Grounds & Farmers Market, Inc.?

A. It did.

[fol. 121] Q. Do you remember the date?

Mr. Rosen: Your Honor, that is all a matter of record.

The Court: September 26, 1951.

Mr. Robbins: All right, fine.

Q. Now, do you remember, Mr. Malakoff, whether Nazareth Fair Grounds & Farmers Market, Inc., the debtor in this proceeding, was incorporated through your office?

A. Well, we had a Pennsylvania attorney form the corporation, yes.

Q. Mr. Malakoff, will you explain why the real estate was transferred from Richard Realty Company to Kipling Realty Company, and then from Kipling Realty Company to Nazareth Fair Grounds & Farmers Market, Inc.?

• • • • • • •

[fol. 122] A. It is our normal practice in acquiring real estate, where a mortgage is going to be created, to take

title in Richard Realty Company, thereby putting that corporation, Richard Realty Company, on the bond and mortgage, subsequently transferring it to Kipling Realty Company. Kipling Realty Company has never executed any bond or mortgage. The purpose of holding title in Kipling Realty Company is because of the fact that Richard Realty Company has executed many, many mortgages; so we just transfer it out of there.

Mr. Robbins: All right.

The Court: I take it, then, that Kipling never assumes any of the mortgages executed by Richard?

[fol. 123] The Witness: That is correct.

* * * * * * *

[fol. 126] Cross examination.

By the Court:

Q. Mr. Witness, you were at the conference, Mr. Malakoff, John Malakoff, was there, and your father was there.

A. Right.

Q. What was said by each one?

A. John Malakoff offered to buy the real estate at the price that we paid for it, plus $30,000, plus another $2800, which covered expenses that had been put into the property by his title expenses and a few other things, he was [fol. 127] to take over the deal and he started making payments.

* * * * * * *

[fol. 139] Cross examination.

By Mr. Robbins:

Q. Did you have any agreement with John Malakoff as to the balance of the moneys due from him to you?

A. None.

Q. No agreement?

A. No agreement.

Q. What is the balance due?

A. I couldn't tell you without actually figuring it out. It would have to be somewhere around $30,000.

Mr. Rosen: May I object—I have a standing objection, your Honor, to all this testimony.

The Court: Yes.

Mr. Robbins: That is all I want to ask the witness, your Honor.

The Court: I understand, however, that you assert no claim against the debtor.

The Witness: That's right.

The Court: What did you say?

The Witness: That is correct.

• • • • • • •

[fol. 144] Cross examination.

By Mr. Margolis:

Q. Now, isn't it a fact that in July of 1951 you referred to a certain conference that your late uncle, John Malakoff, had a one-fourth interest in the partnership at that time?

A. In what partnership?

Q. In the partnership in which Mr. Zoloth was in, Mr. Soble and Murray Realty.

A. That is not so.

Q. Would you say there was no payment or agreement made by Malakoff in July 1951 to pay you about $16,000? When I say "you," I mean Murray Realty.

A. I gave you the dates of the—the exact dates of all the payments that were made.

Q. Well, I ask you now if it isn't a fact that that $16,000, which was to be credited to your late uncle, was for a one-fourth interest in the partnership, and that agreement was prior to October 1951?

A. That is not so.

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[fol. 148] Redirect examination.

By Mr. Rosen:

Q. Did you have a discussion with John Malakoff about the fire loss that Nazareth Fair Grounds & Farmers Market, Inc. had?

A. Yes.

Q. And you know that the fire loss was incurred by Nazareth Fair Grounds & Farmers Market, Inc.?

A. Right.

Q. Not by John Malakoff, personally?

A. Right.

Q. That is correct?

A. Right.

The Court: What fire loss is that?

The Witness: It is our fire loss, wind—it is not fire loss, it is windstorm.

Mr. Rosen: I am coming to that.

The Court: You are coming to what?

Mr. Rosen: Windstorm loss.

Q. When did this windstorm—to your knowledge, when did this windstorm loss occur?

[fol. 149] A. Probably late in '51.

Q. And after the windstorm loss, you became apprised that there was certain insurance payable to Nazareth Fair Grounds & Farmers Market, Inc.?

A. Right.

Q. Then you had a conversation with John Malakoff; correct?

A. Yes.

Q. Did you ask John Malakoff that that check from the insurance company, when payment is made, should be turned over by the corporation to you?

A. That's right.

Q. Is that what transpired?

A. That is what transpired.

Q. Now you knew you were taking a corporation check.

A. Right.

Q. And not Malakoff's personal check.

A. Right.

Q. And you knew that was property of the corporation.

A. Right.

Q. Is that correct?

A. Right.

* * * * * *

[fol. 153] Cross examination.

By Mr. Seligson:

Q. Now I also understood you to say that all of the capital stock of Richard Realty Company was owned by the Murray Realty Company; is that right?

A. That is correct.

Q. And did you not also testify that you and your father made up the Murray Realty Company?

A. That is correct.

Q. Well, now, what does Soble and what does—what is the other name?

Mr. Rosen: Zoloth.

A. Zoloth.

Q. —have to do with the Richard Realty Company, or the real estate, as of that time?

A. Well—

Q. Were they involved in the deal at that time, in March of 1951?

A. Yes.

Q. Well, what interest did they have?

A. Zoloth is the same as Murray Realty Company. That is my brother-in-law. Soble was a partner with us in this transaction. We used Richard Realty Company for purposes of taking title, and Kipling for purposes of holding title. But in actuality the real principals were two parties.

[fol. 154] Q. Two groups?

A. That's right. One group was Murray Realty Company, my dad and myself, and the other group was Soble—

Q. Soble and Zoloth had a 50 per cent interest.

A. Each.

Q. In the deal with the Murray Realty, which was you, and your deal; is that right?

A. No. Soble had a 50 per cent interest in the deal. Zoloth is the same as Murray Realty Company, had a 50 per cent interest of it, too.

Q. Is Zoloth a member of the partnership?

A. Zoloth is my brother-in-law.

Q. Was he a member of the partnership?

A. No.

Q. But he was in on the Murray Realty?
A. That's right.

* * * * * * *

[fol. 181] Direct examination of
Miss Tess J. Schwartz.

By Mr. Rosen:

Q. Miss Schwartz, would you kindly tell the Court the date, the place, the circumstances and the conversations had which resulted in your acquiring three shares of Nazareth Fair Grounds & Farmers Market, Inc. stock?

A. I purchased these in March 1953. My brother and mother both had the same stock and I decided that I would have some too, that I would want to buy some. I was living in Florida at the time. I sent my brother a check to purchase the three stocks for me. I had never had any conversations with anybody else but my family.

* * * * * * *

[fol. 197] HAROLD B. SCHWARTZ, called as a witness on his own behalf, being duly sworn, testified as follows:

Direct examination.

By Mr. Rosen:

* * * * * * *

[fol. 200] And I have the check right here that I made out to John Malakoff for two shares in the Nazareth Farmers Market.

Subsequently I purchased two more shares.

* * * * * * *

[fol. 251] Q. Will you kindly state time, place, who was [fol. 252] present, conversation, with whom, which resulted in the acquisition of two shares of stock of Nazareth Fair Grounds & Farmers Market, Inc., represented by certificate No. 30 drawn on behalf of Gussie Schwartz.

A. On approximately—on the same date as—on approximately somewheres between January 10 and January 14—correction—on January 14th, while at a reception given

by one Helen Bernstein at the Waldorf-Astoria, I gave a check in the amount of $2,000 for the purchase of two shares of Nazareth Fair Grounds & Farmers Market stock for one Gussie Schwartz, my mother.

I presented the check to Miss Helen Bernstein and drew the check to her order, since I asked her if I could purchase some more stock and she said yes. And I said, "Should I make out the check to the Farmers Market?"

She said, "No, make it out to me."

I have the check here in evidence. I also noted on the back that it was for investment in the Nazareth Farmers Market for Gussie Schwartz for two shares. I have the check and the—

• • • • • • •

[fol. 298] Cross examination of
Miss Dorothy Kane.

By Mr. Rosen:

Q. When you purchased these three shares of stock you were purchasing Malakoff stock?

A. I was purchasing stock from Mr. John Malakoff for Nazareth, for the stock supposedly to be for the Nazareth Market.

• • • • • • •

[fol. 343] George H. Bond, called as a witness in his own behalf, being first duly sworn, testified as follows:

Direct examination.

By Mr. Rosen:

• • • • • • •

[fol. 346] The Witness: • • •

A. (Continuing) Friends of mine were talking about Nazareth Market and they thought it was a good investment, and I thought I would invest and buy one share. That's all.

Q. Will you, on behalf on the claimant, will you tell the Court who you spoke to regarding the acquisition of the

share and who you paid, and who delivered the share of stock to you?

A. Share of stock was mailed to me but I never met Mr. Malakoff myself personally. I gave the check to—my check to Harold Masur.

Q. Mr. Masur was your intermediary or agent?

A. Yes, because he was one of my friends. He told me about the stock. So I gave him the check and he turned it over to Nazareth Market, and then I got a certificate.

• • • • • • •

[fol. 468] Cross examination of
Harold Q. Masur.

By Mr. Seligson:

Q. At the time you gave him this check for $3,000 was it supposed to represent payment for three shares of stock?

A. Three shares of stock, yes, sir.

Q. And what stock were you buying or whose stock were you buying?

A. I assumed I was buying stock in the corporation; I was buying it from Mr. Malakoff in whatever capacity he represented the corporation, I don't know.

• • • • • • •

[fol. 469] Q. Isn't it a fact, Mr. Masur, that you thought you were buying a proportionate interest in the Market and not buying stock?

A. Yes, I believe that would be a fairly accurate statement.

Q. So you didn't advance this $3,000 for the purchase of stock but in order to get a proportionate interest in the ownership of the Market?

A. I think that may be fair.

• • • • • • •

[fol. 519] Lawrence Treat, called as a witness in behalf of Blanche Waldman, being duly sworn, testified as follows:

Direct examination.

By Mr. Agins:

• • • • • • •

[fol. 522] A. (Continuing) I went there with my wife and expressed a desire to invest in the Nazareth Farmers Market, which I had heard, and we chatted, and Mr. Malakoff [fol. 523] painted the proposition in very glowing terms, and he said that he had recently acquired it and that the setup was not yet crystallized and he, therefore, gave me a letter in return for a check, stating that the stock certificates and so on were not yet available. As I recall it, it was rather complicated, and I didn't understand the various explanations, but that was the substance of it.

Q. In other words, at that first meeting with Mr. Malakoff you purchased some interest in this proposition?

A. Yes.

Q. What was the extent of that interest?

A. Two 2/100ths.

Q. The amount—

A. Earmarked—

• • • • • • •

[fol. 595] Blanche Waldman, called as a witness in her own behalf, being first duly sworn, testified as follows:

• • • • • • •

[fol. 601] Direct examination.

By Mr. Agins:

Q. Did you handle the details of the purchase of these 6 shares of stock from these two parties?

A. No, my brother handled it.

Q. Your brother's name is Arnold A. Weinstein?

A. Yes, sir.

Q. And he is an attorney, is that correct?

A. Yes, sir.

Q. Are you familiar with the details of the transaction?

A. No, he handled the whole thing for me.

• • • • • • •

[fol. 607] Cross examination.

By Mr. Seligson:

Q. Who suggested to you for the first time that you [fol. 608] should make an investment in the stock of Farmers Market?

A. My brother.

Q. When did he do that?

A. He called me up about a year ago, I would say.

Q. That would be about in May of 1957?

A. In May some time. I don't know the exact day, but I know it was in the spring of the year, and he said that there were some people that wanted to sell their stock in the Market.

I had been out at the Market on various occasions and he advised me, that is, he thought it would be a very good investment if I would be interested in buying the stock. I asked him how many shares were involved and how much it was.

Q. And what did he tell you?

A. He told me it would be $1,000 a share and that there were six shares involved, if I wanted to buy.

Q. Did he tell you that the first time that he called you to talk to you about this investment?

A. Yes.

Q. He told you about the six shares at one time, at the same time?

A. Yes.

[fol. 609] Q. Did he ask you whether you wanted to make an investment to buy that stock at $1,000 per share?

A. Yes.

Q. And what did you say to him?

A. I thought it over very quickly and I said yes.

Q. Right on the telephone, right then and there?

A. Yes, sir.

Q. Did he ask you whether you had the money available to buy the stock?

A. He knew I had the money available.

Q. What is that?

A. He knew I had the money available.

Q. Did you tell him that it would be necessary for you to sell some stock, other stock, in order to pay for the purchase price of these 6 shares?

A. Well, my brother knows my financial position and he is aware of what I own and what I don't own.

Q. Then was anything said about your having to sell other stock in order to buy this stock?

A. He didn't tell me to do anything. He just advised me that it might be a good investment for me. I made the decision myself to buy.

Q. Did he handle your affairs, your financial affairs?

[fol. 610] A. He gives me very good advice.

Q. But does he handle investments for you?

A. He has on occasions when I was a widow, he did.

Q. Now in your discussion with him did he tell you or did you ask him who it was who wanted to sell the stock?

A. I didn't ask him and he didn't tell me. This is the first time I ever met these people.

Q. In other words, you left everything to your brother?

A. Yes, I relied on him.

Q. You relied completely upon your brother?

A. Yes, I did and I do.

Q. That is understandable.

A. Right.

Mr. Weinstein: That is the kindest word I heard today.

Mr. Seligson: What is that?

Mr. Weinstein: I said that that is the kindest word I heard today.

Q. He simply called you and suggested that it would be a good investment and you made a decision right off the bat, so to speak?

[fol. 611] A. Yes, sir.

Q. On the telephone?

A. Yes, sir.

Q. And you said, I suppose, "If you think it is a good investment I will go along with it," or something like that, is that it?

A. Exactly like it.

Q. And the matter was handled completely by him?

A. Yes.

Q. And you didn't know where the stock was coming from?

A. No, sir.

Q. You didn't know anything about the allowance or disallowance of the stock in court and you asked no questions about it?

A. I trusted my brother and I trust my brother implicitly.

Q. I don't blame you for trusting your brother, that is a natural thing.

A. Right.

Q. And you didn't suggest or tell him that in order to buy this stock you would also have to cash government bonds?

A. No, it wasn't necessary to tell him that.

[fol. 612] Q. I just want to know whether you did or whether you did not, that is all.

A. He asked me if I would be interested in buying. I asked him when I would need the money and I arranged to give him the money.

Q. Without discussing where you were to get the money?

A. No, I didn't tell him where I was going to get the money.

• • • • • • •

[fol. 613] Cross examination.

By Mr. Weinstein:

Q. Mrs. Waldman, did any part of the $6,000 that you delivered to me in the form of a check to my order as attorney in any way emanate from me or from any of my bank accounts or cash, to your knowledge?

A. It did not; it was all my money.

Q. In other words, are you assuring this court that the funds which you delivered to me as attorney were wholly and solely your own?

A. They were completely my own.

Q. And that I had nothing to do with respect either to the payment or the delivery of that money to myself; is that right?

A. Absolutely right.

Mr. Weinstein: That is all.
Mr. Agins: That is all, Mrs. Waldman.

(Witness excused).

ARNOLD A. WEINSTEIN, called as a witness, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Agins:

Q. You are an attorney-at-law?
[fol. 614] A. I am.
Q. Duly licensed to practice law in the State of New York?
A. I am.
Q. Are you also the brother of Blanche Waldman?
A. Yes, I am.
Q. Did you superintendent the transaction or the two transactions whereby Mrs. Waldman purchased certain shares of stock from Mr. Masur and from Lawrence Treat?
A. I did.

• • • • • • •

[fol. 622] The Witness: When the transaction was consummated, in so far as complete payment was made to Mr. Masur and to Mr. Treat, it should be borne in mind that I had received $6,000 from Mrs. Waldman which I had deposited into my special account. However I had not [fol. 623] exhausted that fund of $6,000 from my special account by reason of the fact that I had previously advanced out of my regular account the sums of money which were given to Mr. Treat and Mr. Masur on account of the option agreement which I had prepared. And so at the end of the transaction I drew a check to myself out of my special account for $340 and deposited that into my regular account in repayment of the funds that I had expended in connection with this transaction.

• • • • • • •

[fol. 624] Cross examination.

By Mr. Rosen:

Q. Mr. Weinstein, you are president of the debtor?

[fol. 625] A. Yes, sir, I am.

Q. Mr. Weinstein, you know that as president of the debtor that you are a fiduciary?

A. I appreciate that.

Q. Mr. Weinstein, do you know as president of the debtor and that as a fiduciary you are not supposed to go out on the market and purchase stock of the debtor?

A. Yes, sir.

Q. Yet you purchased this particular stock?

A. Not for myself.

• • • • • • •

Q. Mr. Weinstein, do you know that even if there is a family relationship, whether it is a sister or any other type of close relationship, you are not supposed to use your fiduciary knowledge or your office to purchase any stock [fol. 626] of the debtor?

A. I did not use my fiduciary capacity to purchase any stock of the debtor for myself or any member of my family. The fact of the matter was that I did my very, very best to discourage the sale by Mr. Masur and Mr. Treat.

• • • • • • •

[fol. 828] Barry Clark, called as a witness in his own behalf, being first duly sworn, testified as follows:

• • • • • • •

[fol. 830] Direct examination.

By Mr. Rosen:

Q. Mr. Clark, will you kindly tell on your behalf as claimant, date, time, place, who was present and the conversations which emanated in your acquiring four shares of stock of the debtor.

A. Well, the dates are vague to me, but it seems like early in 1951 it was through Harold Q. Masur that I met Helen Bernstein and John Malakoff. And it was about—well, it was about six months later that John Malakoff asked me to buy some stock in the Nazareth Farmers Market. The price was $1,000 a share. I agreed and I bought at that

time—I bought three shares, and about a month later I bought another share.

• • • • • • •

[fol. 881] HELEN ROTHSCHILD or HELEN BERNSTEIN, called as a witness on behalf of the debtor, being first duly sworn, testified as follows:

Direct examination.

By Mr. Rosen:

• • • • • • •

[fol. 911] A. He said that— I said, "How did you get into this thing, Mr. Robbins?"

And he said, "I represent a man who is a butcher at this [fol. 912] Nazareth Market and he hasn't been able to get a satisfactory lease, and that is the reason he placed $50,000 in my account and authorized me to buy stock in the Nazareth Farmers Market, but he didn't have all that money himself. He has a partner, a lawyer, by the name of Phillips, who comes from somewhere up in that area, who recommended me for this purchase of the stock, "for this transaction," or something. And he said, "If you don't mind, you have been a mystery woman in this whole thing. I have heard your name mentioned for the last year and a half, but I have never met you before, and you appear to be some kind of a myth in this Nazareth Market situation."

• • • • • • •

[fol. 935] He said, "As a matter of fact, my tenant, my client, is willing to go as high as $8,000 a year rent."

• • • • • • • •

[fol. 1090] Cross examination.

By Mr. Margolis:

A. All I can tell you, Mr. Margolis, is that Mr. Malakoff [fol. 1091] always needed money, whether he needed it for rent in the Wales or the Margaret, or whether he needed it for dividends, or 20 per cent, or whatever he needed it for. He needed money every single day he lived. I wouldn't remember a discussion about any particular rent. He always needed money.

• • • • • • •

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VOLUME II

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1962

No. 70

IRVING J. WOLF, ET AL., PETITIONERS,

vs.

ARNOLD A. WEINSTEIN, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 21, 1962
CERTIORARI GRANTED APRIL 2, 1962

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962

No. 70

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Katzenell Exhibit 7—Katzenell Book of Account (John Malakoff account, 1950 & 1951)	10609	563
Masur Exhibit 8—Letter receipt dated September 11, 1951 from John Malakoff to Harold Qu. Masur for $4000	10611	566
T. Schwartz Exhibit 5—Letter receipt dated March 20, 1953 from John Malakoff to Harold B. Schwartz for $3000	10612	567
Treat Exhibit 4—Letter receipt dated September 11, 1951 from John Malakoff to Larry Treat for $2000	10613	568
B. Clark Exhibit 5—Letter receipt dated August 1, 1951 from John Malakoff to Barry Clark for $4000	10614	569
Removal: Wolf's Exhibit 25—Letter receipt dated April 22, 1959 from Arnold A. Weinstein to Jerome Fried for $2,200	10615	570
Removal: Wolf's Exhibit 44—Extract from lease dated December 29, 1956 between Nazareth Fair Grounds & Farmers' Market, Inc. and J & J Foods, Inc.	10616	571

	Original	Print
Proceedings in United States Court of Appeals for the Second Circuit	10618	572
Opinion, Friendly, J. (Docket 26362), dated November 9, 1961	10618	572
Judgment	10632	584
Order denying petition for rehearing (Docket 26362)	10635	585
Clerk's certificate (omitted in printing)	10636	586
Opinion, Moore, J. (Dockets 26962 and 27000), dated November 9, 1961	10637	586
Judgment	10653	600
Order denying petition for rehearing (Docket 27000)	10656	601
Clerk's certificate (omitted in printing)	10658	602
Order allowing certiorari	10659	602

[fol. 1417] RUTH SPIELHOLZ, one of the claimants herein, called as a witness in her own behalf, being first duly sworn, testified as follows:

Direct examination.

By Mr. Rosen:

• • • • • • •

[fol. 1418] Q. Of the debtor's stock.

A. Mr. Malakoff was a friend of the family for many years and in September, 1951 I met him, my husband and myself, at my sister's house, and he was there with his sister.

Q. What is his sister's name?

A. Gertrude Klein; and at that time he spoke about this Nazareth.

[fol. 1419] Q. What did he say to you?

A. Well, he spoke—he told my husband that he thought it was—that he would get a good return for his money, that he would get a good return if he should make an investment in the Nazareth Corporation.

Q. And did you agree to make an investment?

A. Well, not right then and there, no. My husband and I talked it over, and I think about a week or two later we sent him $1200.

• • • • • • •

[fol. 1446] ROSE KAPLAN, called as a witness in her own behalf, being first duly sworn, testified as follows:

Direct examination.

By Mr. Rosen:

• • • • • • •

[fol. 1448] A. And in the course of conversation my husband talked to Mr. Malakoff and he suggested to buy stock in Nazareth.

• • • • • • •

[fol. 1457] MORTON SAMET, called as a witness in his own behalf, being first duly sworn, testified as follows:

Direct examination.

By Mr. Rosen:

• • • • • • •

[fol. 1461] Q. Was there any conversation relating to the investment?

A. Yes.

Q. Or was this money merely given to Malakoff as a loan?

A. Well, he spoke about some situation in Pennsylvania, farmers market. I even went down and visited the Farmers Market with him and his son—and I guess that was all—his daughter, son-in-law and daughter.

Q. So when you speak of an investment, you speak of an investment in Pennsylvania of a farmers market, and you are exhibiting two checks which you claim are for this particular investment?

A. Yes, sir.

Mr. Rosen: Debtor offers in evidence check dated April —I withdraw that—check dated March 14, 1951.

The Court: You didn't mean to say "debtor"? You meant to say "claimant", didn't you?

Mr. Rosen: Claimant. You are right, claimant, please, check dated March 14, 1951, to the order of John Malakoff [fol. 1462] for $1,500, drawn on the First Freeport Bank, signed by Morton Samet, and check dated April 10, 1951, to the order of Mr. John Malakoff for $500, same bank, signed by Morton Samet, as the check for $1,500. There are signatures on the reverse side, or what purport to be the signatures, of John Malakoff, John Malakoff, Agent—I am sorry, "Off Agent"—"Off" period "agent." Similarly on the $500 check.

(Marked Claimant's Exhibit 2 in evidence in the Samet matter.)

• • • • • • •

A. I received a letter and also certificate. This certificate, unfortunately, was mislaid or lost, but I have the letter. The certificate was for two shares.

• • • • • • •

[fol. 1463] Q. Did you receive any income or profits from John Malakoff on this $2,000 transaction?

A. Yes, sir, I did.

Q. What did you receive?

A. Approximately—I don't know the exact amount of [fol. 1464] money, but approximately 17 or 18 checks $33-and-some-odd-cents.

Q. I show you a series of checks, commencing with September 1, 1951, to May 1, 1953, totaling 18 in number, each in the sum of $33.34, and ask you whether you received them on the transaction in question?

A. Yes, sir.

Q. Does your endorsement appear on the reverse side of each of those checks?

A. Yes, sir.

Q. Those checks appear to be signed by John Malakoff, John Malakoff, Agent, and John Malakoff, Special, is that correct?

A. Yes, that is correct.

• • • • • • •

[fol. 1465] Q. Did you agree to take $2,400 in cash for your $2,000 investment with John Malakoff?

A. No, sir. There is something to the effect on that letter, that I had no idea the meaning of, and I still to this day don't know the meaning of it.

Q. Did you agree to take $2,700, October 12th, four months from the time you gave him the $2,000? In other words, take $2,700 for the $2,000?

A. No, sir.

• • • • • • •

[fol. 1472] Q. Didn't you have an arrangement with Mr. Malakoff how much he was to pay you each week or each month on each of these loans of $1,460?

A. Yes. I have forgotten the amount though.

Q. What was the rate?

A. I don't know whether it is 18 per cent or 16 per cent, but in there, in that vicinity.

• • • • • • •

[fol. 1476] Mr. Rosen: I offer in evidence the following checks on behalf of debtor:

Check dated February 27, 1952, on the Freeport Bank, to the order of John Malakoff, in the sum of $1,000, signed by Morton Samet. On the reverse side, Re Hotel Margaret. 64 So. Grove Street, Freeport, New York, John Malakoff, John Malakoff, Agent.

• • • • • • •

[fol. 1479] The Court: You asked him to read the letter.

The Witness: You did.

Mr. Rosen: All right, he can read it.

The Witness: Want me to read the letter?

Mr. Rosen: Go right ahead.

The Witness: "June 12, 1952.

"Morty Sameth:

"It is understood that you have invested in the sum of $2,000 which is a part share (1/32nd) in a deal, which is known as Nazareth Market. Purchase price was $85,000. Mortgage," I think it is, "$18,000. Now, all you have to do is take profits.

"Jack."

In the lefthand corner is "$2,400 cash, $2,700 October 12 (four months). What would you take? It's an excellent deal.

"Jack."

• • • • • • •

Q. Purportedly, as you read this, on October 12, 1952, [fol. 1480] Mr. Malakoff was to give you $2,700?

A. That is not a fact.

Q. On that $2,000?

A. No, sir, because I got the 33.33 checks after this, even after October 12th. So it is impossible for me to get $2,700 plus the 33.33. I have no understanding what that means. You are just speculating or guessing.

• • • • • • •

Q. Kindly be responsive. But you at no time objected to Mr. Malakoff, by letter, or by phone, or by conversation, [fol. 1481] as to these memos on the bottom of Claimant Samet's Exhibit 3, $2,700, October 12th, four months?

A. No, sir.

• • • • • • •

[fol. 1501] Cross examination.

By Mr. Seligson:

Q. So those two checks refer to returns on an investment you made with Mr. Malakoff in the Hotel Margaret; is that your testimony?

A. Part of it, I guess. I don't recall precisely now. I am trying to search and help you, but I know those two checks must be because of what it says on the back. They aren't in my handwriting, incidentally.

• • • • • • •

[fol. 1503] Q. Dr. Samet, will you look at these four checks you have produced, each for $16.67, and tell us whether these aren't additional checks you got in connection with the Hotel Margaret?

A. Yes, sir, they are.

• • • • • • •

[fol. 1527] Q. Did you get a return of 20 per cent on your money with respect to all of the moneys which you advanced to Mr. Malakoff?

A. I don't believe I did, no, sir.

Q. I show you these checks, each for $16.67, signed by John Malakoff, Special, and payable to the order of M. Samet, and ask you whether you got these moneys?

[fol. 1528] A. Yes, sir.

Q. Did you get those moneys in connection with the moneys you advanced to John Malakoff on the Hotel Margaret?

A. I don't recall specifically except one of these things is marked that. I don't recall in what regard I got these.

• • • • • • •

[fol. 1548] Direct examination of
Cydney Grossman.

By Mr. Rosen:

Q. And is that based on an understanding that you were to get 20 per cent income on an investment of $2,000?

A. Yes, sir.

• • • • • • •

[fol. 1557] Direct examination of
Mrs. Mae Bluestone.

By Mr. Weiswasser:

Q. Will you tell us just what he did say.

A. Well, he said, "The dividends will be 20 per cent and it will be $1,000 a share and that it is a wonderful thing, and that he thinks it is going to be a grand thing and one of the best things he had. And he said—well, I hesitated, and then he said, "Look at these people sitting outside. They have been investing with me for years." Some man was sitting in the outer office, and that's all, and he told me—

• • • • • • •

[fol. 1660] Cross examination of
H. Lawrence Laupheimer.

By Mr. Robbins:

Q. Is that correct?
A. Yes, that's correct.
Q. Did he request the return of that note?
A. No, he did not.
Q. Did he ever request the return of that note?
A. No, he never did. In fact, he told me, when he gave me that legal sheet that I signed, that he would ask for that back when I got my stock certificate, and I didn't, and I forgot it. In fact, it was just on this old feeling—and, if it means anything—he told me at one time that he didn't need to ask for things back from people. "You [fol. 1661] don't have to write anything. My work is done on my bond; my honor is my bond and my hand shake."

• • • • • • •

[fol. 1695] Dorothy Holober Clark, called as a witness in her own behalf, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Rosen:

• • • • • • •

[fol. 1697] The Witness: That was early in 1951.

A. (Continuing) And shortly after that Mr. Malakoff asked me if I would like to buy some shares in Nazareth Farmers Market, and I told him that I didn't have any cash available but that I was interested, and I would like to own 3 shares if I could pay it off, and he consented. I don't remember who was present exactly at that time.

• • • • • • •

[fol. 1731] Q. Did you sign any other papers or memoranda, if you recollect, other than the stock certificate in so far as this transaction was concerned?

A. I signed a paper. I can't remember exactly how it read but it was to the effect that Mr. Weinstein didn't think I should sell this stock because it was good and that I should hold on to it and that I was aware of that fact.

. . . . . .

[fol. 1738] Cross examination.

By Mr. Weinstein:

Q. Now then, Mrs. Clark, in the initiation of this transaction leading up to the sale by you of one of your three shares of your Nazareth stock, would you please tell the Court who approached whom, whether I approached you or whether you approached me, for the purpose of selling this stock?

A. Well, I approached you because I had received, or, [fol. 1739] I should say, we had, not myself alone, we had received an offer to buy our stock from some other people and I didn't know who the people were that wanted to buy it. We were approached by an attorney named Buchwald, and so we decided then—or I think he offered us eight or nine hundred dollars a share, or something like that, and we didn't want to sell for that, and so then we got—we called you, and I was the one who asked you to sell that share for me, or rather three of them at the beginning, and one later.

. . . . . .

[fol. 1752] Cross examination of
Robert A. Noire.

By Mr. Rosen:

Q. Do you know what capital stock of a corporation is?

A. Well, I tell you the truth, Helen Bernstein told me this is a stock from Nazareth Corporation, and that is a stock. I never bought stock before. I just came to this country; was saving this hard money. I bought this stock. I didn't ask whether capital or any kind. I bought a stock.

Q. But your understanding was then that you were buying the stock of the corporation, original issue?

A. Yes.

Q. Direct from the corporation?
A. Yes.
Q. In other words, your understanding was not that you were buying stock that was issued first to John Malakoff and then bought by you?
[fol. 1753] A. No.

• • • • • • •

[fol. 1844] Direct examination of
Lazar Karapontso.

By Mr. Rosen:

A. November 10, 1952. Offhand I wouldn't remember exactly what Mr. Malakoff said outside of praising the Market, saying it was a good deal to get in on, and tell me about the 20 per cent on each share. It was $1,000 a share.

• • • • • • •

[fol. 1846] Q. Have you that stock certificate with you?
A. Yes. And he also wrote on the back of it.

Mr. Rosen: The witness specifies, "This represents 2 $1,000 shares, $2,000. You will receive a 20 per cent dividend per annum payable in equal monthly payments of $33.34 on the first day of each month."

• • • • • • •

[fol. 1890] Direct examination of
Ernest Pollak.

By Mr. Robbins:

Q. What were you to receive for those two checks, Mr. Pollak?
A. Nine shares.
Q. Of what?
A. Of the Nazareth Farmers Market.

• • • • • • •

[fol. 1987] Direct examination of Charles Kanter.

By the Court:

Q. Excuse me, just a moment, Mr. Witness. There was a time when you and Eddie Malakoff and John Malakoff and Mr. Mintz and two other people were in Malakoff's office, right?

A. Yes, sir.

Q. It was a morning?

A. Yes.

Q. Some time in 1951?

A. Yes, sir.

Q. Can you recall the season of the year? Was it in the winter, summer?

A. I think it was in the summer.

• • • • • • •

[fol. 1988] Q. Eddie Malakoff said something. What was it?

A. That he has a quarter of a Market in Pennsylvania for sale for $16,000.

Q. Yes?

A. And there was four of us decided to go in. I said, "I'll take a quarter of the quarter," and I put up $4,000.

• • • • • • •

[fol. 1991] Q. Tell us what happened on that occasion, what was said and what was done.

A. Accepted, that we decided to take the quarter of the Market.

Q. When you say "we" is it only the four or the whole—or John Malakoff also?

A. The four.

Q. All right.

A. But I want to bring out, John Malakoff became a partner. He gets a certain part of our profits when we sell. That was all the arrangements with Malakoff.

Q. What was said at that meeting after you returned from the Market, when you six people were in John Malakoff's office?

A. We decided to take the quarter of the Market.

Q. What was done?

A. We put up the $16,000.

• • • • • • •

[fol. 1993] Q. But I understood you to say that John Malakoff had a contingent interest, a share in the profits, if you sold your $16,000 interest?

A. Yes, sir.

Q. Is that correct?

A. Yes, sir.

Q. When and where and by virtue of what words did that arrangement arrive?

A. Just by words.

Q. When?

A. At the time when we bought the Market.

Q. That day that you put up the cash?

A. That day they put up the cash.

Q. What was said that led you to believe that that was the arrangement? Who said what?

A. John Malakoff said that, "You know the way I go in a deal, that I get"—I don't recall, I think it was—"10 per cent of the profit which is being made on the share at the time if and when it is sold."

• • • • • • •

[fol. 2027] Q. I want you to come here and trace for me penny for penny—

A. All right.

Q. —every deal that you had with John Malakoff from the beginning to the end, if we stay here until Christmas.

A. All right, sir.

Q. You can't come in here and just chalk off $1,300 and say that it probably was profit on some other deal. We do not do business that way here. I want an accounting, penny for penny.

• • • • • • •

[fol. 2219] Cross examination of
Richard S. Hull.

By Mr. Rosen:

Q. Did you handle any legal documents for the sale of the stock of the corporation?

A. No. For the sale of the stock?

•

Q. Yes.

A. No.

Q. Did you prepare any contracts involving the sale of the stock of Nazareth Fair Grounds & Farmers Market, [fol. 2220] Inc.?

A. Just the one between Mr. Robbins and myself but not before—but not while John Malakoff was alive.

Q. Were you acting as attorney in any of the deals prior to the reorganization of Nazareth Fair Grounds & Farmers Market, Inc. in the sale or transfer of the stock of Nazareth Fair Grounds Farmers Market, Inc.?

A. Now wait a minute. Let me amend that. There were two cases, but that rose out of different situations that I remember.

There was Kanter's case. He had an interest in the Margaret Hotel and I drew up an agreement with reference to that, where there was a transfer. Mr. Malakoff agreed to transfer stock to him, and I think I did the same thing with the Dancigers on some property in Roslyn, where I was the attorney on the Roslyn property and I was the attorney on the Margaret Hotel, but not as attorney for Nazareth.

Q. You drew up the contracts involving the sale or transfer of stock—

A. It was not a sale, it was a transfer of interest from one corporation to another.

Q. So you did draw contracts involving the sale and [fol. 2221] transfer of stock of Nazareth, is that correct?

A. That is correct.

* * * * * * *

[fol. 2255] Cross examination.

By Mr. Weinstein:

Q. Did you ask Mr. Malakoff what you were going to get for your $3,600 or whatever it was you were going to give him?

A. Yes. He said he wasn't sure whether it was going to be set up as a partnership, or a limited partnership, or a corporation. That would be determined later.

* * * * * * *

[fol. 2321] COLLOQUY BETWEEN COURT AND COUNSEL

Mr. Rosen: If your Honor pleases, this is an application by the debtor for authorization to enter into a lease which is expiring at the end of this month. In place of the Rehrig lease—the Rehrig lease, your Honor is expiring—we have a new tenant at a much higher rental, your Honor, and the debtor merely makes this application, your Honor.

• • • • • • •

[fol. 2324] Mr. Robbins: Your Honor, Mr. Rehrig bought his business from Mr. Drucker four years ago and at that time he bought his business there was an agreement signed [fol. 2325] that contained a restrictive covenant. Mr. Drucker said he would not go into business in the market for a period of five years. There is still one year to run on that.

Now, our feeling on this matter essentially is that Mr. Drucker is the principal or one of the principals involved in this new lease that is being proposed by the debtor.

The Court: Have you got proof?

Mr. Robbins: Your Honor—

The Court: I am not interested in your feelings. You want to equal this lease? You want to match it?

Mr. Robbins: Your Honor—

The Court: Yes or no? Do you want to match this lease?

Mr. Robbins: Your Honor, I don't consider that a fair offer. What I am trying to say is that this payment—

The Court: I am cutting you off. You will have all the opportunity you want to say whatever you want, but I am asking you now first, regardless of the reason,—

Mr. Robbins: Yes.

[fol. 2326] The Court: Do you want to match the lease? Yes or no?

Mr. Robbins: At fifteen thousand, your Honor?

The Court: Yes.

Mr. Robbins: Your Honor, my client will match the lease in order to stay there.

The Court: All right.

Mr. Robbins: But what I am trying to say, your Honor, is that I honestly believe—I will give you the facts in a

moment—that this $15,000 for a one-year lease—I know only about the Brill lease; I have received no papers on Delphino.

The Court: It is the same lease. It will be executed by Brill and Delphino and they will put up $2500, two months security.

Mr. Robbins: Your Honor, I understand that. My position on this is that the $15,000 does not represent all rent. What it represents in part is a payment to the corporation for putting Rehrig out and putting Drucker back in.

The Court: I don't care. Rehrig has no vested right. His lease comes to an end on August 31 and I am going to get the best lease I can for that spot. I am not interested [fol. 2327] in your fights among yourselves.

Mr. Robbins: Your Honor, that is quite true. There isn't any dispute but that the corporation, the debtor, ought to get the best rent possible.

The Court: Exactly, and we have got an offer here of $15,000 with two months collateral, a one-year lease with a two-year renewal clause and I am saying to your man he should be given consideration if he is prepared to accept equal terms.

• • • • • • •

[fol. 2329] Mr. Rosen: I understand this is a heavy day for him and Mr. Brill is working presently, true, for Drucker, Judge. He works for him; there is no question about it. But Brill says, "I don't care if the Judge feels I am not entitled to it or anything he asks; let Delphino take the lease. My feeling is if Delphino wants it either we go in jointly or if Delphino wants let him take it himself and I will work for him."

In other words, "I have no connection"—

The Court: Do you claim there is any connection between Delphino and Drucker?

[fol. 2330] Mr. Robbins: Well, there is through Brill, your Honor. That is our position on it. Drucker and Brill are brothers-in-law.

The Court: Excuse me just a minute.

Mr. Rehrig, are you prepared to pay $15,000 a year with two months security for that space which you are in now?

Mr. Rehrig: Yes, sir.

The Court: You are?

Mr. Rehrig: Yes, sir.

The Court: All right, I will favor the present tenant. You got the same lease.

• • • • • • •

[fol. 2332] The Court: No, because if they are going to come in with proof that there is a connection between Brill vis-a-vis Delphino and Drucker and what aspect that may have on the lease I don't know. They say there is a viola-
[fol. 2333] tion, that this is a subterfuge to violate a restrictive covenant between Drucker and Rehrig. I don't know. I am not going to get into all of this now because if you fellows have any sense before the 12th you will enter into a lease at $15,000 a year with $2500, two months rent, security, between Rehrig and Nazareth.

Mr. Rosen: I know, Judge. If he is ready to accept it we are ready, too.

The Court: Well, he says he is ready to accept it and I am stating now that it will be identically the lease proposed here without any provisions or any alterations, improvements or anything else. You are to get no more than Delphino or Brill or both of them would have gotten under this lease.

• • • • • • •

[fol. 2337] The Court: You are not going to use the Court as a bargaining proposition and get somebody else to come in now and offer 20. You should have done that before. You have got to deal in fairness with the people that are in.
[fol. 2338] They have come up to the fifteen thousand, they have matched it, they have agreed to put up two months security, they ask for no better terms than those in the lease you have submitted to the Court; I will not entertain these further applications. So don't go looking for bargains.

• • • • • • •

[fol. 2339a] Reporter's Certificate to foregoing transcript (omitted in printing).

[fol. 2409] Direct examination of
Charles Kanter, resumed.

By Mr. Robbins:

Q. Did you get any money back, Mr. Kantor, on this East 3rd Street deal? I call your attention to your checkbook entry for August 16, 1951, that is, in Exhibit 22.

A. It says, "J. Malakoff, $500, East 3rd Street, New York City," check back for $500.

• • • • • • • •

[fol. 2413] A. 19, yes. It says "$500 check," it has a notation there, "Maywood, $500."

Q. In other words, the checkbook indicates you received two checks from John Malakoff, one on July 12, 1951, the other September 19, 1951, aggregating $975?

A. Yes, sir.

Q. $475 plus $500?

A. Yes.

• • • • • • • •

[fol. 2416] A. I gave a—we were buying a leasehold—we, I mean, Malakoff and myself—were buying a leasehold of the Margaret Hotel in Brooklyn, and I gave him a check to his attorney, made out to his attorney, Richard Hull, a certified check of $7,000, when they went to sign the contract.

Q. This was an investment in this Hotel Margaret at leasehold, you say?

A. That is correct.

• • • • • • • •

[fol. 2417] Q. Anything further on the Hotel Margaret?

A. Yes, on June 16, 1952 I made out a check to the New York Telephone Company for $1,000 as a deposit on the telephone for the Margaret Hotel.

• • • • • • • •

[fol. 2418] Q. Was there any more money given to John Malakoff on this Hotel Margaret deal?

A. Yes, sir, on July 10, 1952 I gave him a check for $2,000, made out to the Ambassador Estates and that was for—they were—

Q. Is that the check?

Mr. Rosen: I would like him to complete the answer.

A. Yes. They were short money at that time. We needed additional money. Decorated the lobby, and we were making additional repairs in the building, and we put up additional money for the repairs, and I gave him a check for $2,000.

• • • • • • •

[fol. 2426] Q. All right. What did you say to him and what did Mr. Malakoff say?

A. Mr. Malakoff said that he has some people who are interested that he can sell my share in the hotel, in the Margaret Hotel, if I was willing to exchange my interest in the Margaret Hotel for shares at the Nazareth Market.

Q. Did he identify those people?

A. Well, as far as I could think of, there was one party in there, working at the hotel, I don't recall his name, I [fol. 2427] don't know his name, and there was also another party there at the time, I think was Jerry Fried's brother.

Q. Julius Fried?

A. I don't recall his first name.

Q. Did Mr. Malakoff tell you that these two gentlemen wanted to buy an interest in the Hotel Margaret?

A. He did not tell me that but when I went to the Market—the Market—rather, when I went to the hotel, to check there once in a while, I met those two parties in there, in the hotel, and they told me that he promised them to give them some of my share into that hotel.

Q. Mr. Malakoff did not identify those people as the people who wanted your interest in the Margaret Hotel?

A. He did not.

Q. What else did Mr. Malakoff say about the Margaret Hotel at this meeting in April?

A. At this meeting in April he asked me if I would exchange my interest from the hotel to the Market, and I said I would.

• • • • • • •

[fol. 2433] Q. The other certificate, comprising Exhibit 12, certificate No. 71 for eight shares, what did you give John Malakoff for that?

A. I gave him $4,800, which it was—he owed to me on [fol. 2434] the Wales Hotel. It didn't go through on the sale at that time and on January 15, 1952 I requested he give me some kind of receipt, and he issued this receipt to me that "I now, in the course of this arrangement"—"In the course of my management of the market, I may cause to be issued to you 20 shares of my present stock holdings."

• • • • • • •

[fol. 2458] Cross examination.

By Mr. Rosen:

Q. And your statement that you didn't give him anything except what you got records of, that was a true statement when you made it?

A. Literally.

• • • • • • •

[fol. 2519] Q. Then at no time, and until the time you purportedly claim you made a transfer of stock, of Ambassador stock, into Nazareth stock did you receive one cent on your Ambassador deal, is that correct?

A. That is correct.

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[fol. 2520] Q. Mr. Kanter, did you go to John Malakoff and tell him you weren't satisfied that Ambassador was making money and that they were going to increase their expense by hiring a Mr. Fried as manager and that under the circumstances you wanted to get out of the deal and exchange the deal for something else?

A. I don't recall.

Q. You don't recall what you testified to on an examination in July 1958, sir?

A. I do not.

Q. Did you ever testify you were not satisfied with the management?

Mr. Robbins: Page number?

A. Mr. Rosen—

Mr. Rosen: I will come to that.

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[fol. 2521] Q. On page 55 of the examination:

"Did you have a discussion with Malakoff in April 1953 regarding the Ambassador Estates, its mismanagement and so forth?

"A mismanagement? No, I wasn't satisfied with the management; yes."

A. That is correct. That is my answer.

Q. Isn't it a fact you made your trade with Malakoff of Ambassador stock for Nazareth stock because the investment wasn't making any money and he was going to put in a new manager so there would be further loss of money and additional expenses?

A. I did not so testify.

The Court: He didn't ask you whether you testified to that. He asked you whether that is the fact.

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[fol. 2712] Direct examination of
Seymour Forman.

By Mr. Patur:

Mr. Patur: May I explain it this way? I think I am not speaking out of turn when I give the following short resume of the facts here: A loan was made by the claimant to a corporation known as Ambassador Estates, a $5000 loan; another $5000 loan was made to Wales Properties by this claimant; then a $5000 loan was made to the debtor corporation by this claimant, and at the time that the loan to the debtor corporation was made, the two previous loans on two other corporations were renewed at the same time, and an agreement was drawn up by John Malakoff wherein he stated that he gives to Seymour Forman as col-
[fol. 2713] lateral security 15 shares of the debtor corpora-

tion stock for the three $5000 loans which I have mentioned, which stock is to be returned in the event these indebtednesses are paid. If not, the shares of stock are to belong to the claimant as collateral security.

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[fol. 2718] Q. Now, Mr. Forman, on that same day, March 12, 1953, did you lend to Nazareth Fair Grounds & Farmers Market, Inc., the debtor, the sum of $5000?

Mr. Rosen: If your Honor please, I object to the form of the question.

A. I did.

Mr. Rosen: And I ask that the transaction—

The Court: Sustained. It is leading.

Q. When you met Mr. Malakoff on March 12, 1953, will you tell us what transaction you had with him on that day in relation to the debtor corporation?

A. Only to the debtor corporation? Only to that? He asked me for a loan of $5000 for the corporation and I gave him a check and he gave me a note for it.

Q. We are talking about the Nazareth Fair Grounds & Farmers Market transaction, Mr. Forman. Did you—

[fol. 2719] Mr. Rosen: I am sorry, Judge. I am really sorry. Could I hear the answer? I missed one word.

(Record read.)

Q. I show you this note, Mr. Forman, and I ask you whether that is the note which you received from the debtor corporation through Mr. John Malakoff?

A. Yes, this is the note, yes.

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Q. Mr. Forman, what form or how was this $5000 that you gave to Mr. Malakoff made up? How was it constituted?

A. First of all he demanded cash. He needed the cash to make good certain dividend checks that he had made

[fol. 2720] out. That is his explanation. I went to the bank and I drew out $1900 on one check; cashed it.

Q. What bank was that, Mr. Forman?

A. That was the Marine Midland Bank. And at that time I had cash that I had collected on other real estate projects, and whatever cash I had minus the bonus that he gave me—

Q. Tell us first, how much more cash did you have in addition to the 1900?

A. That was 1600.

Q. 1600? That makes 3500?

A. That is right.

Q. How was the other $1500 made up?

A. Well, he had told me that in order to extend the other two transactions, which would be—

Q. Which other two transactions?

A. Ambassador Estates—

Q. The Ambassador Estates transaction?

A. —and Wales Properties, Inc., and $500 that he would give me as a bonus on this transaction made up the other $1500; that I should bring only altogether $3500.

Q. Let us get this clear: This $1900 check, which you [fol. 2721] cashed, on the Marine Midland Trust Company, $1600 in cash which you had makes $3500, and then Mr. Malakoff gave you $500 bonus on the Nazareth loan and a $500 bonus on the Ambassador extension and the Wales extension—

A. Wales extension.

Q. —is that it?

A. That is correct.

Q. That made up the $5000?

A. That is right.

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[fol. 2740] Q. Now, Mr. Forman, coming back to the loan that you testified about to Ambassador Estates, Inc., do you remember when that loan was made by you to Ambassador Estates, Inc.?

A. That was made on August 28, 1952.

Q. And at that time did you give to Ambassador Estates, Inc. your check for $5000?

A. Let me see it.

(Check handed to witness.)

A. Yes, this is the check.

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[fol. 2742] Mr. Patur: The point is this, if your Honor please: This witness testified before that on March 12th he renewed a loan to Ambassador Estates and renewed a loan to Wales Properties.

The Court: Yes.

Mr. Patur: At that time—well, I don't think it is fair of me to testify, but I am trying to get out of this witness the mechanics that were used at the time.

Mr. Rosen: He has already testified.

Mr. Seligson: Doesn't that note say when it is due?

Mr. Patur: This statement tells us when it is due but that is not the note that Mr. Forman received on August 28th.

The Court: We will come to that. Do you want to offer it now?

Mr. Patur: Yes, I want to offer that in evidence.

Mr. Rosen: Same objections, if your Honor pleases, as those previously made.

The Court: Overruled.

(Marked Claimant's Exhibit 11 in the Forman claim.)

[fol. 2743] The Court: Now, I take it that the bank's advice, appended hereto, that on July 1, 1953 the note of August 28, 1952 was returned by the Corn Exchange Bank, and marked "insufficient funds," is not being offered now as part of this exhibit but that you will develop that with proper testimony?

Mr. Rosen: Your Honor, we will concede that it was returned by the bank and save time.

The Court: All right, fine. Then all of the papers making up Claimant's Exhibit 11 in the Forman claim, i.e., the note itself, the green Corn Exchange Bank advice of return, and the notice of the Marine Midland dated July 6, 1953, are in and constitute Claimant's Exhibit 11.

Q. Now, Mr. Forman, would you tell us on what date this Claimant's Exhibit 11, which is dated August 28th,

on what date did you actually receive it from Mr. John Malakoff?

A. I received this on March 12, 1953.

Q. On August 28, 1952, did you receive a promissory note from Mr. Malakoff at the time that you made the loan to Ambassador Estates?

A. Yes, I did.

Q. And what happened to that promissory note?

[fol. 2744] A. That was destroyed and a new one given to me on March 12, 1953.

The Court: The new one being Claimant's Exhibit 11, is that correct?

The Witness: Sir?

The Court: The new one being that note that counsel holds in his hand, Claimant's Exhibit 11?

The Witness: Yes, sir.

The Court: Let me ask you this question: You did receive a predecessor or prior note on August 28, 1952?

The Witness: Yes, sir.

The Court: Was that for $5000?

The Witness: $5000.

The Court: And when was it due, Mr. Forman, do you recall?

The Witness: It was due March 12th.

The Court: On the due date what did you do with it?

The Witness: I presented it to Mr. Malakoff for payment and he said he could not pay it at that time.

The Court: All right. And what did he do with it?

The Witness: He destroyed the original.

[fol. 2745] The Court: He tore it up?

The Witness: Tore it up and gave me this one and marked the original date, the time of the original date of the loan.

Direct examination.

By the Court:

Q. When you gave Malakoff or Ambassador Estates the $5000 check on August 28, 1952, did you receive any bonus or any part of it back?

A. I received a bonus at that time.
Q. From whom?
A. From Mr. Malakoff.
Q. Of how much?
A. If I can remember, about $250.
Q. In what form?
A. In cash.
Q. So that when you gave him the $5000 check marked Claimant's Exhibit 10 in the Seymour Forman claim he gave you back $250 in cash?
A. Yes, sir.

The Court: All right.

Direct examination.

By Mr. Patur:

Q. Now, Mr. Forman, on the same day, August 28, 1952, did you also lend to Wales Properties, Inc. $5000?
A. I did. Yes, I did.
[fol. 2746] Q. I show you this check and ask you whether that is the check which you delivered to John Malakoff as president of Wales Properties, Inc.?
A. He wrote it out; it is his handwriting; yes.

Mr. Patur: I offer it in evidence.
Mr. Rosen: Your Honor, may I have a standing objection on all of these documents that haven't got Nazareth's name on it at all, Malakoff as president, on the grounds previously stated on the admission of this type of document?
The Court: You may, and it is overruled.

(Marked Claimant S. Forman Exhibit 12 in evidence.)

Q. And did you receive from Wales Properties, Inc. this promissory note August 28, 1952, from Mr. Malakoff?
A. I did.
Q. What?
A. I did.

Mr. Patur: I offer that in evidence.
Mr. Rosen: Same objection.

The Court: Same ruling, overruled.

Mr. Rosen: That note also includes protest notices, your [fol. 2747] Honor, the same as the other one, and they can all be marked as one exhibit.

The Court: All right.

(Marked Claimant S. Forman Exhibit 13 in evidence.)

Q. Now, Mr. Forman, is the same thing true in connection with this loan that you made to Wales Properties, Inc., the getting of the note, the getting of the check and the renewal of the note on March 12, 1953; is it true as to Wales Properties, Inc. the same as you testified before as to Ambassador Estates, Inc.?

A. This was done at the same time.

Q. And in the same manner?

A. In the same manner.

Q. Now, Mr. Forman,—

The Court: May I interrupt a moment? Am I to understand by that testimony that on August 28, 1952 you gave Mr. Malakoff $5000 and you received a note due March 12, 1953, and that on March 12, 1953, when you presented that note to Mr. Malakoff for payment by Wales Properties, Inc., he said they didn't have the money, and he destroyed that note and he gave you Claimant's Exhibit 13 in place of it?

[fol. 2748] The Witness: That's right, the two transactions are the same, yes, sir.

The Court: On August 28, 1952, when you gave Malakoff Claimant's Exhibit 12, which is the Forman check of $5000 drawn to the Wales Properties, Inc., did you receive anything back?

The Witness: Yes, I received the same amount of $250.

The Court: And that was also in cash?

The Witness: It could be in cash or check, your Honor; I don't remember exactly, but I did receive it.

The Court: I pause to inquire of the debtor's counsel whether any checks from Malakoff to this claimant appear to have been made out on August 28 of 1952?

Mr. Rosen: No, your Honor. On August 8th there is a check for $250.

The Court: All right, proceed.

Q. Now, Mr. Forman, neither the Ambassador Estates note nor the Wales Properties, Inc. note was paid, is that correct?

A. No, no.

Q. And did you bring an action—

Mr. Rosen: Excuse me, your Honor, I am sorry. Was [fol. 2749] your question that in August he got two checks of $250 or in March he got $250, the same as the other one?

The Court: Wait a minute. His testimony was that in March he got $1500, $500 on Wales, $500 on Ambassador and $500 on Nazareth.

Mr. Rosen: Thank you, your Honor.

The Court: The testimony originally was that in August he got $250 on Ambassador and then I asked him whether he got the same thing on Wales, and he said yes.

Mr. Rosen: Thank you, your Honor.

Q. Did you bring an action in the City Court, New York County, against John Malakoff and Ambassador Estates, Inc. on that $5000 note?

A. I did.

Q. And did you obtain a judgment against John Malakoff and Ambassador Estates, Inc. in the City Court?

Mr. Rosen: Your Honor, I have the same objection.

A. I did.

The Court: Overruled.

Mr. Rosen: Thank you.

The Court: I want to pause for a moment, Mr. Patur. [fol. 2750] It might have just been a slip of the tongue in framing the question, but you asked, "Did you bring an action in the City Court on the $5000 Ambassador note and the $5000 Wales Properties note?" Do you mean separate actions?

Mr. Patur: I meant separate actions on each one.

The Court: All right.

Mr. Patur: May I at this time offer in evidence the file in the action of Seymour Forman against John Malakoff and Ambassador Estates, Inc. of the City Court of the City

of New York, New York County, under Index No. 13059—1953, and the file in the same court in the action of Seymour Forman against John Malakoff and Wales Properties, Inc. under Index No. 13060—1953?

The Court: Wait a minute. Let us take one at a time.

Mr. Patur: Pardon me, your Honor.

Mr. Rosen: Same objection as previously stated.

The Court: Overruled.

The first one that was offered was the file of the City Court of New York County No. 13059—1953, Forman against Ambassador and Malakoff. Mark that one first. [fol. 2751] That is deemed marked and the parties will agree as to the papers, and they will, when they are collated and turned over to the clerk, be marked Claimant's Exhibit 14.

(Deemed marked Claimant S. Forman Exhibit 14 in evidence.)

The Court: Now the next one. What was the number of the City Court file on that one, the one against Wales?

Mr. Patur: 13060—1953.

The Court: And the same course will be pursued as to that file, which will be deemed marked Claimant's Exhibit 15. The debtor's objection being overruled.

(Deemed marked Claimant S. Forman Exhibit 15 in evidence.)

Q. Now, Mr. Forman, were you ever paid any part of any one of these $5000 loans?

A. No, never.

Q. Do you know what the condition of the corporation known as Ambassador Estates, Inc. is?

Mr. Rosen: I object.

A. Defunct.

The Court: Sustained; strike out the answer.

Q. Mr. Forman, before the bringing of these Chapter X [fol. 2752] proceedings and subsequent thereto have you received various notices addressed to you as a stockholder of the debtor corporation for attending such meetings?

Mr. Rosen: If your Honor pleases, I object to that. It has no bearing. The matter was already in litigation.

The Court: Sustained.

Mr. Ratur: No further questions.

Cross examination.

By Mr. Rosen:

Q. Do you have any books or records of transactions that you had with John Malakoff during the years 1951, 1952 and 1953?

A. No, I did not.

Q. You had no records?

A. No book.

Q. Do you have any records?

A. No.

Q. Were you asked on the examination before trial held on September 5, 1958, the following questions and did you give the following answers:

"Q. Do you have any checks that were drawn, checks that you gave Malakoff for the year 1951?

"A. Unfortunately, since I had been disconnected with [fol. 2753] Mr. Malakoff, I had bought a store, and the records that I had, which I would put my head on, I finally found that the whole box of them are missing. I don't have them. The reason why I didn't diligently get it then is because I knew in the proceedings that we had in City Court, John Malakoff admitted that he got the money and that he owed the money, and he admitted that he got the money and that he owed the money to me, therefore, I didn't keep a record any more."

Were you asked that question and did you give that answer?

A. Did I give at that time, yes.

Q. Did you also testify unequivocally later on in the examination that you did have books and records but you lost them in this store?

A. I could explain this if your Honor would allow me.

The Court: Where is that inconsistent with the present testimony? What is the inconsistency?

Mr. Rosen: He claims when I asked him—he said he had no books or records.

A. I have not; I still don't have—

The Court: Just a minute. The question was not ad-
[fol. 2754] dressed to you, Mr. Forman.

Mr. Rosen: I will come to the books and records.

The Court: Wait a minute. I want to know what there is that he testified to in this trial that is inconsistent with what you are reading from the deposition.

Mr. Rosen: I asked him if he had any books or records, your Honor, of his transactions—

The Court: Will you read Mr. Rosen's first question back?

(Question read.)

The Court: That is "Do you have." That is the present.

Mr. Rosen: I am sorry.

Q. Did you have any books or records in the years 1951, 1952 and 1953 of your transactions with Malakoff?

A. Only checks records.

Q. You never had any other books or records?

A. No.

Q. At the end of the year 1951 you had no open transactions with John Malakoff, is that correct?

Mr. Patur: May it please the Court, I object to that. I
[fol. 2755] don't think that the testimony is relevant here to the matter before the Court at this time.

Mr. Rosen: Your Honor, there were checks and payments in the subsequent years that will be brought in—

The Court: Overruled. Answer the question.

A. What is the question again?

(Question read.)

A. I myself, no.

The Court: By that are we to understand that you mean that you did have no open transactions or unconcluded transactions as of that time?

The Witness: No, your Honor. It might be a transaction which was in somebody else's name that I took care of.

The Court: The only reason that I asked my question is that the answer "No" is ambiguous, because of the form of the question which could be taken five different ways.

Q. You had no money due you from John Malakoff and you had no investments?

A. I must answer again, I myself, no; I myself.

[fol. 2756] Q. Mr. Forman, did you testify that you gave Claimant S. Forman Exhibit 12 to John Malakoff for Wales Properties, Inc. on August 28, 1952?

A. I gave that money—I did testify.

The Court: Will you please keep your voice up?

The Witness: I am sorry.

Q. And that you received a note from John Malakoff payable March 22, 1953 and that you did not receive this note, Claimant S. Forman Exhibit 13, this identical note?

The Court: Did you mean to say March 22nd or did you mean to say March 12th?

Mr. Rosen: March 12, your Honor.

The Court: All right.

A. What is the question again?

(Question read.)

A. I don't understand the question. I don't even understand that.

Q. You gave John Malakoff on August 28, 1952 Claimant S. Forman Exhibit 12, is that right?

A. On this date, yes.

Q. But you did not receive on that date Claimant S. Forman Exhibit 13, is that right?

[fol. 2757] A. I did receive the note with that. Yes, I did.

The Court: Take Claimant's Exhibit 13 in your hand, Mr. Forman. Hold it. Have you got it?

Give it to him, Mr. Rosen.

Mr. Rosen: It is right in front of him.

The Court: Is that the one you got on August 28, 1952?

The Witness: No, sir.

The Court: That is all Mr. Rosen asked you.

The Witness: I didn't understand him, your Honor, I am sorry. I did not receive it.

The Court: You tore up what you gave to him on March 12th or he tore it up and he gave you this one?

The Witness: That's right; that's what I said before.

Q. On your examination before trial on September 9, 1958, were you asked the following questions and did you give the following answers:

"Q. What did you receive on August 28, 1952 from John Malakoff?

"A. I received notes.

"(Paper was handed by counsel.)

"Mr. Rosen: Claimant exhibits a note dated August 28, [fol. 2758] 1952, for $5000, signed Wales Properties, Inc., John Malakoff, President, and on the reverse side appears the notations, John Malakoff, Seymour Forman as agent; attached thereto is a protest notice."

Were you asked that question and did you exhibit that note as having received it on August 28, 1952?

A. I understand the same way as I understood you now and I answered the same way—I did not understand it; you didn't put the question to me right.

Q. Were you asked that question and did you give that answer?

A. Did I give that answer? Probably yes, I suppose. I didn't understand it. Now that I understand it—

Q. I merely asked you, Mr. Forman, were you asked that question and did you give that answer?

A. Yes, I gave—I must have given that answer. I rely on the record.

Q. And then:

"Mr. Rosen: Claimant produces note dated August 28, 1952 for the sum of $5000, to the order of claimant, signed Ambassador Estates, Inc., John Malakoff, President, and [fol. 2759] on the reverse side appears the notation, John Malakoff, Seymour Forman, agent. I ask that the note be marked for identification together with the protest notices attached."

Mr. Seligson: Is there a question?
The Court: Not yet.
Mr. Rosen: Not yet.

Q. And were you asked this question and did you give this answer:

"Q. Did you have any other transaction with John Malakoff for any company he was connected with in between August 28, 1952 and July 3, 1953, when it appears that Debtor's Exhibits 4 and 5 were protested?
"A. I don't understand that question.
"Mr. Rosen: Read the question.

"(The last question was read.)

"Q. Meaning, those notes in between those dates, did you have any other transactions?
"A. No."

Were you asked that question and did you give that answer?
A. As I must have understood it at that time, yes.
Q. Were you asked that question—
[fol. 2760] A. If you would ask me questions which were relevant, like the $2000 which I have here a check, which came back, I would be able to answer those questions. The way you put the questions to me I couldn't understand them at all.
Q. Mr. Forman, will you kindly respond. Were you asked that question—
A. I am responding.
Q. —and did you give that answer?
A. I am responding, yes. I answered at that time—I did not understand it but I answered it.

The Court: Excuse me just a moment. At the time that you were asked that question and the word "transactions" was used—
The Witness: Yes, sir.
The Court: —what did that mean to you with respect to Wales and Ambassador?

The Witness: It meant this, your Honor: Where I got $250 for these here two transactions, I gave him a $2000 check; he gave it to me ahead of, to help him out for the weekend, from Friday to Monday, a few transactions of that sort, no profit, no consideration whatsoever, just the plain ordinary favor to him, if he wants to mix in these [fol. 2761] years, those are transactions, but I didn't understand what he meant, which I think I have a case. Didn't we have a $2000 recently—

The Court: Strike that out.

Mr. Patur: Just answer the questions, Mr. Forman, which are put to you. Don't volunteer any answers.

The Witness: Okay, I am sorry.

By Mr. Rosen:

Q. Did you tell this Court that you received some moneys or payments on these notes in advance or at the time you gave him the money for these notes?

A. I say yes, $250 each on these two here notes, and $500 each on the renewals at that time.

Q. Were you asked this question and did you give this answer:

"Q. Did you receive any moneys or payments, or did your wife receive any moneys or payments, or anyone on your behalf from John Malakoff, or any firm connected with him between the dates of August 28, 1952 and July 3, 1953?

"A. No, sir."

A. I didn't understand your question.

Mr. Patur: May it please the Court, I rise to indicate [fol. 2762] that Mr. Rosen was referring to other transactions, that is, transactions other than these.

The Court: Even if he were not I fail to recognize any inconsistency because of the fact that the man testified that he received $250 in each transaction on August 28th when he gave him the checks, and the question is between August 28th and July 3rd.

Q. Isn't it a fact that you extended these notes on July 13th?

A. This is not a fact, no.

Q. Of 1953?
A. No. July 3, 1953, two of them.
Q. You extended them to when?
A. Two to July 3rd and one to July 13th, on March 12th.

The Court: We will take a recess.

(Short recess.)

By Mr. Rosen:

Q. Later on in the examination were you asked the following specific questions and did you give the following specific answers, beginning at page 25:

"Q. I would like for the moment the dates. As you claim you are confused, let us try to confine it to the transac-
[fol. 2763] tion.
"A. All right, to the transaction.
"Q. Try to refresh your recollection from the transaction.
"A. Right.
"Q. You spoke of one transaction which took place on August 28, 1952, where you gave Mr. Malakoff two checks for $5000 each, is that correct?
"A. Yes, that would be August 28th, two notes.
"Q. Here are the checks?
"A. Yes, August 28th.
"Q. Then on August 28, 1952, when you gave Malakoff these two checks for $5000 each, he gave you these two notes of $5000 each dated August 28, 1952, Ambassador Estates, Inc.?
"A. Right.
"Q. And Wales Properties? Correct so far?
"A. Right.
"Q. Those notes were payable on July 3, 1953? Look at the date on the notes. Is that correct?
"A. Yes."

Were you asked those questions and did you give those answers?
A. I don't recall the questions being asked like that, but
[fol. 2764] it is incorrect. I stated today the correct dates and that's the truth.

Q. Now by July of 1953 Malakoff was already in trouble; isn't that correct?

A. I wouldn't know about that.

Mr. Patur: I object to the question, if your Honor please.

The Court: Overruled.

Q. What is your answer?

A. I am not the expert to know if he was in trouble.

Q. You weren't advised that he was not paying dividends and that he was not meeting his debts in May, June and July?

A. No.

Q. Did you receive any dividends in June or July?

A. Any dividends?

Q. Yes, on investments in Nazareth.

A. No, I did not receive any.

Q. How about April or May, did you receive any dividends in April or May on Nazareth?

A. The only things I received was $500 bonus. I didn't receive no—

Q. You did not receive, however, dividends in April, May, [fol. 2765] June or July, is that right, 1953?

A. No, I didn't.

Q. Let us get back to today's story and let me kindly ask you this: On March 12, 1953 Malakoff didn't have the money to meet the two notes that you claim were original notes payable on March 12, 1953, is that correct?

A. March 12, 1953?

Q. That's right.

A. At that time he wanted them extended.

Q. He did not have the money, he said, and told you so; isn't that right?

A. He told me so.

Q. What?

A. Yes.

Q. And yet you gave him $5000 more in money, you claim?

A. Yes, I certainly do claim, certainly.

Q. As regards your books, on page 8, Mr. Forman, were you asked the following questions and did you give the following answers:

"Q. Any ledger, any memorandum books?

"A. Whatever books I had was together with all the other records.

[fol. 2766] "Q. Which you now claim were lost?

"A. That's right."

Were you asked those questions and did you give those answers?

A. I meant checkbooks; I have no records. I testified to that. I have no books.

Q. Did you say checkbooks or books together with all other records?

A. If I said it. I meant my checkbooks, which I didn't have any checkbooks. I have been looking for them ever since.

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[fol. 2781] Q. Mr. Forman, didn't you testify in a proceeding in this court that you cashed two checks and took the cash of the two checks to Mr. Malakoff for the $5000?

A. I possibly did.

Q. What?

A. I possibly did.

Q. Which testimony is true? Did you cash two checks for $5000 or did you cash one check for $1800 or something or advance interest?

A. As I got the question—

The Court: Would you read the question back to the witness?

(Question read.)

The Court: Now, is either one of them true?

The Witness: Both of them are not true.

[fol. 2782] The Court: Next question.

Q. And do you claim that you cashed two checks one at the Marine Midland and one at the Sterling National Bank for $5000?

A. That is the same question; I said I did.

Q. You mean you so testified under oath?

A. As I understood at that time, as to my recollection, yes.

Q. And did you cash those two checks—

A. I have to get the bank records to refresh the memory.

Q. And did you cash those two checks on March 12th for the $5000?

A. I did not cash the checks. One check and cash—

Q. Did you testify that you—

The Court: Let the witness complete his answer. Did you complete your answer?

The Witness: One check and the cash plus the $1500, that was the bonus.

Q. Did you testify that you cashed two checks for $5000 on March 12, 1953?

A. On that date, yes, I testified. I think I remember it [fol. 2783] now, yes, I did.

Q. Now you testified in court that you didn't cash two checks, is that correct?

A. That's right. I recollect now. It refreshed my memory.

Q. It was after I asked—

The Court: Stop the argument. What is your next question?

Q. Isn't it a fact that you refreshed yourself after I asked for the copy of the bank reports to see the withdrawals?

A. I asked for them. I made out the—

Q. No, but I asked that they be brought to the examination; isn't that true?

A. I signed and demanded that long before—I demanded the copy from the bank.

Q. Did you have them before the examination?

A. No, there was a removal of the bank, one of the banks, and they couldn't furnish them to me, long before you asked for them.

Q. Now you had a subsequent examination on October 28, 1958, the previous one having been on September 9th. Were you also mixed up on October 28, 1958 or was your mind in a settled condition?

[fol. 2784] A. I want to make a statement: The way you asked the questions I was confused on that examination too—the way you asked the questions.

Q. On the examination of October 28th, on page 37, were you asked the following questions and did you give the following answers as regards the checks and notes, Exhibits 2 and 4:

"Q. Mr. Forman, on what date did you give Debtor's Exhibit 2 for identification to John Malakoff?

"A. August 28, 1952.

"Q. On what date did you receive Debtor's Exhibit 4 for identification of 9/8/58?

"A. August 28, 1952."

Were those answers true when you made them?

A. I don't know. At that time I couldn't—

Q. That was at the beginning of the examination, the first two or three questions?

A. Why, I don't even know what exhibits you refer to. Show me what it refers to, the exhibits.

Q. Plaintiff's Exhibits 2 and 4, 2 being the check of August 28, 1952 to Wales Properties, Inc., and Plaintiff's Exhibit 4 being the $5000 note given to you on Wales Properties, Inc.

The Court: Just a moment. Is Plaintiff's Exhibit 2 for [fol. 2785] identification in the deposition of this witness in October Claimant's Exhibit 12 in this trial, and is Plaintiff's Exhibit 4 for identification in that deposition Claimant's Exhibit 13 at this trial?

Mr. Rosen: Yes, your Honor.

The Court: All right.

Q. I ask you to look at the examination and see if those are the first three or four questions that were asked when the examination started that day.

A. Whatever it is here, I couldn't understand what you said to me that day. Honestly, I couldn't answer them.

Q. That was on the second day, you couldn't understand?

A. That's right, on the second day. You knew that, the way you put those questions to me, I couldn't answer them, I don't know.

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[fol. 2803] Cross examination.

By Mr. Weinstein:

Q. On March 12, 1953, just so I understand you, Mr. Forman, the total amount that you gave to Mr. Malakoff on this Nazareth loan transaction as represented by the note that you received, was the $1900 stemming from the withdrawal of $1900 from the bank, as you have testified, is that so?

A. That's right.

Q. And $1600 which you said that you had in cash on [fol. 2804] your person, is that correct?

A. Yes.

Q. That is a total, of course, of $3500?

A. $3500.

Q. And that is all that you gave to Mr. Malakoff in exchange for which you received this $5000 note, is that correct?

A. After he told me to deduct $500 on the renewals and $500 on the Nazareth.

Q. Yes.

A. That made it net.

Q. The net payment—

A. That's right.

Q. —made by you was only $3,500, is that right?

A. That was according to his request.

Q. But that was all that you paid him?

A. That's right.

Q. His request or not, is that so?

A. Correct.

• • • • • • •

[fol. 2807] Q. When you had completed the discussion about the security then what happened?

A. Then I gave him the money and he gave me the stock, which he endorsed.

Q. Did he take this stock certificate out of a stock certificate book?

A. Did he take the stock certificate? I didn't notice. He had a book, a stock certificate book, on the desk but—

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[fol. 2920]

STIPULATION OF COUNSEL RE GILBERT SUNSHINE

Mr. Rosen: It is stipulated and agreed by the attorneys present in this proceeding that if Gilbert Sunshine were to testify, he would testify that he was the accountant for the Ambassador Estates, Inc. in the month of April 1953, and that the books and records of Ambassador Estates, Inc. indicate that Ambassador Estates, Inc. did not pay its rent pursuant to its lease for the month of April 1953, and that Ambassador Estates, Inc. as tenant, was in default under such lease for non-payment of rent.

Mr. Seligson: That is agreed to.

[fol. 2927] Direct examination of
Louis P. Como.

By Mr. Rosen:

Q. When did this second transaction take place, who was present, what was the conversation and where?

A. It took place at 240 Madison Avenue in 1953, the very [fol. 2928] beginning—I went down and I bought four more shares, two for myself and two for my brother Frank.

Q. What was said at that time?

A. I paid the $4,000, two for me and two for Frank each and I got a receipt for it, a stock receipt.

* * * * * * *

[fol. 2966] LOUIS P. COMO resumed.

Direct examination.

By Mr. Rosen:

* * * * * * *

Q. Do you recall when that occurred, and refresh your recollection if you can as to the time you made yours and when you made his.

A. In February when I bought the four shares, then after, about March, I went to Patsy and I says, "Gee, Pat, over here is a good deal. Do you have some money you want to invest? There's some shares you can buy, because I already have six and Frankie has six."

He said, "How many could I buy?"

I said, "Let me find out."

So I called up Mr. Malakoff, and I said, "John, my brother wants to buy some shares into the market." I said, "How many could he buy?"

He said, "He can have six."

[fol. 2967] I went up and told Patty and I say, "Pat," I says, "over here you can get six shares for $1,000 apiece and you will get a check every month; it's a good investment."

* * * * * * *

[fol. 2999] Cross examination of
Seymour Forman, resumed.

By Mr. Seligson:

Q. And at the time you made these loans I understand it to be your testimony that John Malakoff executed and delivered to you these promissory notes of Ambassador Estates, Inc. and Wales Properties, Inc., marked Claimant [fol. 3000] S. Forman Exhibits 11 and 13, is that right?

A. That is correct.

Q. Please understand me, I am not saying, it is my understanding that these three notes, which have been marked Exhibits 11 and 13 were delivered to you by John Malakoff at the time you advanced the $10,000 to Wales and Ambassador; is that true or not?

A. These two were delivered to me on this date?

Q. That's right.

A. No.

Q. That is not true?

A. Not true, because they had been renewed.

Q. In other words, these are not the notes—that is your testimony now—these are not the notes that were given to you by Malakoff on August 28, 1952; is that true?

A. That is right.

Q. Is that your testimony?

A. My testimony has been that they had been renewed.

Q. Please; I just want to know if that is your testimony. It is, isn't it?

A. Yes.

[fol. 3001] Q. When were the notes due—

A. Due—

Q. —that were given to you by Malakoff on August 28, 1952?

A. March 12.

Q. March 12, 1953?

A. '53.

Q. Was there any special reason why these notes, the notes that you say were given to you on August 28, were made payable on March 12?

A. Was there any reason?

Q. Yes. Why March 12 instead of March 1st, or March 15 or April 1st?

A. To his convenience, according to how he wanted it, that is all.

Q. Did Mr. Malakoff tell you that he wanted to borrow $10,000 which would be repaid on March 12, 1953?

A. If I can remember correctly, he didn't want it to fall on the first because he would have certain payments to make. So he asked for the 12th, and I gave him the 12th.

Q. This is September, October, November, December, January, February and March. So that you were lending [fol. 3002] him or lending the corporation this $10,000 for about six and a half months, is that true?

A. That is true.

Q. Did Mr. Malakoff ask you to lend the corporation $10,000 for six and a half months?

A. Yes.

Q. Is that what he said to you?

A. That is right. We made that for six and then up to the 12th would be six and a half.

Q. I don't understand you. You made it six, which would make it—

A. And I wanted—

Q. —February 28th.

A. I wanted it on the 1st or 28th. He said, "It would be better for me to have it on the 12th, 12th of March."

Q. So he asked you for a six months loan?

A. That is right.

Q. You agreed finally to give him this extra half a month because he might not have the money on the 1st of the month, is that it?

A. As a matter of convenience for him, certain payments he would have to make, should be easier for him to make on the 12th.

[fol. 3003] Q. Did you discuss with Malakoff on August 28th the amount of the bonus that you were to get?

A. On when, on March?

Q. March 28th.

A. A few days before.

The Court: Just a minute.

Q. I am sorry, on August 28th.

A. What was that?

Q. Did you discuss with Malakoff on August 28th the amount of bonus that you were going to get for lending him $10,000 for six and a half months?

A. Yes, we discussed it, and, to the best of my knowledge, it was $250 for each.

Q. You talked about it with him?

A. Yes, sure.

Q. How much did you ask for?

A. I had to talk to make a deal.

Q. How much did you ask for originally?

A. How much did I ask for originally?

Q. Yes.

A. No, I left that to him.

Q. What did you say to him?

A. I didn't say anything to him.

Q. He asked you to lend him $10,000?

[fol. 3004] A. That is right.

Q. What did you say?

A. What did I say?

Q. What did you say when he asked you to lend him $10,000, "Yes, I'll give it to you"?

A. I told him I wanted $500.

Q. You asked for $500?

A. Yes.

Q. Bonus?

A. Mutually agreed.

Q. That was mutually agreed that you would get $500 bonus, is that it, and you didn't ask for any larger bonus? Didn't you ask for a thousand dollar bonus immediately?

A. Did I ask for a thousand?

Q. Yes.
A. No, I didn't. I don't recollect and I am sure I didn't.
Q. Was it agreed that the notes would bear interest?
A. No.
Q. You were going to let him have this $10,000 for a bonus of $500 without any interest being paid on the loan—on the notes?
[fol. 3005] A. It said no interest on the notes.
Q. I am asking you what the agreement was.

The Court: Just a minute.

A. I mean—

The Court: Mr. Forman, you say it said no interest on the notes. You don't have here the notes that he gave you on August 28th. The notes you have are notes he gave you on March 12th.
The Witness: I testified they were similar to this.
The Court: Answer the question and don't—
The Witness: Similar to this.
The Court: —don't give explanations. I don't care what it says anywhere. Answer the question, please.
The Witness: That is right.

Q. Did you talk about interest on the promissory notes?
A. On the 1st?
Q. On August 28th, 1952.
A. Yes.
Q. You did? What was said about interest?
A. We mutually agreed $500 for the two transactions.
Q. That was to cover interest and bonus?
[fol. 3006] A. Interest and bonus.
Q. Cover everything?
A. Yes.
Q. That you were to get?
A. That's right.
Q. Did you in September of 1952 get any money from John Malakoff?
A. September?
Q. September of 1952.
A. 1952?
Q. Yes. That is to say, you or your wife, Yvette Forman.

A. I cannot remember. I don't remember that.
Q. Did you get a bonus from him in that month?
A. September?
Q. Yes, in the month of September 1952.
A. It is too long ago that I should commit myself to say if I remember. I don't remember.
Q. You might have gotten a bonus from him, is that it?
A. (No answer.)
Q. Is that your testimony?
A. No, I don't think I got anything.
Q. Is it your testimony you don't remember or is it your [fol. 3007] testimony that you didn't?
A. My testimony is I don't remember.
Q. You just don't remember whether you did or not, is that it?
A. Yes.
Q. If I say to you, in the light of your testimony, that John Malakoff in an affidavit which was sworn to on the 9th day of July 1953, within one year after these loans were made, said as follows, "On August 28, 1952"—and which affidavit is included in the file of the City Court action instituted by you against Mr. Malakoff and against Wales, which file was put in evidence by your attorney—

The Court: Claimant's 12.

Q. —Claimant's Exhibit 12—if I say to you that John Malakoff said as follows, "On August 28, 1952 I borrowed $10,000 from Mr. Seymour Forman for my personal use. I gave him two notes, one for the Wales Corporation for $5000 and one for the Ambassador Corporation for $5000 because he wanted to have it done that way. I paid him $1000 interest each month for the first two months in cash because he didn't want to take a check", and you would say that you don't remember whether that is true or not?
[fol. 3008] A. No, I would say it is absolutely false.
Q. Then is it your testimony that—
A. My testimony that I did not receive that—
Q. —you did not receive a thousand dollars?
A. That is right.
Q. In interest in August when you made the loan and another thousand dollars in interest—

A. Absolutely.
Q. —or bonus?
A. Untrue.
Q. One minute. In September 1952.
A. Untrue.
Q. How much did you get in September 1952 from Mr. Malakoff by way of bonus?
A. I didn't get anything that I can remember because August, September, one month—
Q. September.
A. No, no money yet.
Q. You didn't get any money from him?
A. No, sir. Also, the statement that it was loaned to him personally is absolutely untrue.

Mr. Seligson: I ask that that be stricken out, your Honor.
The Court: Strike it out.
[fol. 3009] The Witness: It was read in the record, you said.

Q. Will you please answer questions?

The Court: Mr. Forman, your counsel got up at the opening of court today and requested that you be handled very tenderly because you are tired and you don't feel well.
The Witness: Well—
The Court: All I can say to you—keep quiet—all I can say to you, sir, is that if you want tender handling, don't invite otherwise by making gratuitous and unsolicited statements.

Q. I show you Claimant S. Forman Exhibit C and I direct your attention to the deposit of $500 that was made here on September 9 and ask you what was the source of that fund.

The Court: Would you read that question.

(Record read.)

The Court: That is Examiner's C.
Mr. Seligson: I am sorry.

Q. (Continuing) Examiner's Exhibit C in the S. Forman matter and direct your attention to this $500 deposit that

was made on September 9, 1952, and I ask you what was the source of those funds.

[fol. 3010] A. That could have been the $500 check I got for the bonus for the two transactions.

Q. Isn't it a fact, Mr. Forman, that Mr. Malakoff gave you whatever bonus it was, whether it was $500 or a thousand dollars, that he gave it to you in cash?

A. In cash, the beginning, at the outset? No.

Q. Are you testifying that you gave him these two $5000 checks and that he in turn gave you a $500 check of his own?

A. That is right.

Q. Or one of the corporations?

A. A check of—it might be his own or—

Q. But you say you got a check?

A. I got a check.

Q. Whose check was it?

A. For $500. I don't remember whose check it was. I can't remember that.

Q. You are sure it was a check?

A. Check of $500, I know. This was—

Q. Were you in the habit of keeping checks for $500 and more on your person or elsewhere without depositing them?

A. Yes.

Q. For a period of two weeks?

[fol. 3011] A. John Malakoff's checks, yes.

Q. Was there some special reason given to you by Malakoff for not depositing that $500 check at once?

A. The special reason is that when I was in his office and I had various transactions, in buying, selling real estate, and if he asked me to hold a check for a little longer time, yes.

Q. Did he ask you to hold it?

A. Did he? Yes, he did ask me—

Q. He did?

A. —on plenty of occasions.

Q. I am not asking you about on other occasions.

A. Yes.

Q. I am talking about what he did when you gave him the $10,000. Did he ask you to hold this $500 bonus check?

A. He possibly didn't ask me.

Q. Did he or did he not?

A. I don't remember. I don't know.

Q. You don't remember what the source of this deposit of September 9th was?

A. Possible, yes.

Q. You don't remember?

A. I don't remember.

[fol. 3012] Q. Do you have any record that would enable you to give us that information?

A. I have no records whatever, only check records. That was my only records I kept.

Q. Did you make an entry on your checkbook of the receipt of a bonus of $500?

A. Entry on the checkbook?

Q. Yes.

A. No, not—I make an entry as to money, that's all. What it is, I don't remember.

Q. Where is your checkbook, checkbook you used in 1952?

A. That was part of all the records which we have to subpoena now that was lost in a transaction when I had moved three different times.

Q. Did you make an income tax return for 1952?

A. I certainly did.

Q. Do you have a copy of that income tax return?

A. No, I don't have a copy of it here.

Q. Do you have it at your home?

A. It could be in the whole records, like the checks and everything that I kept together for each year.

Q. Did you in October 1952 get a bonus or any interest [fol. 3013] from Malakoff, or Wales or Ambassador, on the $10,000 loan?

A. No.

Q. I call your attention to Examiner's Exhibit C in this matter and to the deposit of $500 made on October 1 and I ask you what was the source of those funds.

A. I couldn't tell you now. I don't know.

Q. You weren't engaged—

A. Not from Malakoff.

Q. How do you know—

A. Yes.

Q. —it was not from Malakoff?

A. I was engaged in small transactions.

Q. What transactions were you engaged in in October 1952?

A. With Malakoff it could have been—

Q. Then you got that money from Malakoff?

A. No, it could have been something that I made with the transactions with—not in these transactions but real estate transactions.

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[fol. 3019] Q. Then when you went in to see him, you sat down to talk to him. He said to you he wanted to extend the Wales and Ambassador notes?

A. Right.

Q. Is that it?

A. Yes.

Q. Then you said, as I understood before, if you wanted to make the $500—it wasn't clear to me.

A. To make $500 each for the extension of these two notes—of these two notes. So I said, "Yes, I'll extend it."

Q. For $500 each?

A. That is right.

Q. For a bonus of $500 each, and how long an extension did he want?

A. Until July 3rd.

Q. In other words, he was saying to you in March 1953, according to you, that despite the fact that business was good both at the Ambassador and the Wales he wanted an extension and he was willing to give you $500 bonus on each note to extend it—the time of payment from March 12 to July 3rd?

A. Right.

Q. In other words, a period of about three and a half [fol. 3020] months?

A. Three and a half months.

Q. Is that it?

A. That is right.

Q. You had before, you testified, asked him only $250 as a bonus for making the loan?

A. I said we mutually agreed.

Q. A loan of six months—excuse me—a loan of six months and now you say that he voluntarily offered to give you $500—

A. That is right.
Q. —on each note?
A. That is right.
Q. For an extension of three and a half months?
A. Yes, sir.
Q. Did you say anything at the time to him about security?
A. Then?
Q. Yes.
A. Yes.
Q. What did you say about security?
A. How about the other loan, the Nazareth loan? Yes, in conjunction with the three.
Q. Did he ask you for any additional moneys?
[fol. 3021] A. Yes, he asked me for $5000 for Nazareth Fair Grounds, Inc.
Q. Did he tell you that his company needed $500, the Nazareth Company needed $5000?
A. He said that it needed $5000.
Q. Are those the words he used?
A. Yes.
Q. That Nazareth needs $5000?
A. He wants $5000 for Nazareth Fair Grounds, Inc. loan.
Q. That is what he told you, now?
A. Yes.
Q. He wants $5000 for Nazareth Fair Grounds & Farmers Market—
A. That is right.
Q. —Inc.?
A. That is right.
Q. What did you say?
A. What did I say?
Q. Yes.
A. I said, "I will give it to you."
Q. Did you say anything else?
A. Well, the only thing that I did do—to him at that time?
[fol. 3022] Q. Yes.
A. I said, "I have to investigate and find out some things."
Q. Was this before you told him that you would extend the Wales and Ambassador loans?

A. That's right.

Q. You told him you would have to investigate something?

A. Yes, sir.

Q. Did you tell him what it was you wanted to investigate?

A. Yes, I wanted to go down to Richard S. Hull, which was my attorney too at that time in various things, and his attorney, and I wanted to know how good the market—what he knew of how good it was doing, and if it warranted for me to make the extensions and to give him the $5000.

Q. What did the market have to do with the extension of the loans on Wales and Ambassador?

A. I wouldn't have extended those two notes, if not—if the market wasn't doing well enough and if Mr. Hull wouldn't recommend it.

Q. Didn't you believe Malakoff when he told you that Wales and Ambassador were doing well?

[fol. 3023] A. Did I believe him?

Q. Yes.

A. I didn't want to believe him.

Q. What?

A. I didn't want to believe him. I wanted to investigate.

Q. What had happened between August 28, 1952 and March 11—and March 8th or 9th or 10th, whenever you saw him, to make you change your opinion as to the soundness of the loans to Wales and Ambassador?

A. What made me?

Q. Yes. You said you didn't want to believe him when he told you—

A. That is right. They were due and I wanted to get my money. That's what.

Q. He asked you for an extension and offered to give you twice as much bonus as you had gotten when the loan was made and you say you weren't satisfied with him, you wanted to make an investigation of Nazareth?

A. That is right, yes, sir.

Q. What did Nazareth have to do with the extension of the Wales and Ambassador notes?

A. I wanted collateral. I wanted security for the three

[fol. 3024] notes.

Q. Is that what you told—
A. Yes, sir.
Q. —Malakoff?
A. Yes, sir.
Q. The first time you went down?
A. That's right.
Q. To talk about the—in response to his invitation to come down?
A. That is right.
Q. You told him then that you wanted security in the form of Nazareth stock to cover Ambassador and Wales notes?
A. Yes. He had the stock, he owned the stock; I knew that he was principal owner there.
Q. You didn't ask him for security on August 28, 1952, did you?
A. August 28th? No.
Q. You weren't concerned about your loans then?
A. I wasn't concerned?
Q. Yes.
A. I was concerned, yes.
Q. You were concerned?
A. Yes.
[fol. 3025] Q. Then too?
A. Yes, I was concerned.
Q. Isn't it a fact that because of your concern you charged a very high bonus and that what Mr. Malakoff said in his affidavit concerning what he paid you is true?
A. Is absolutely untrue.
Q. After you went away, left him, did you see Mr. Hull?
A. Yes.
Q. Did you come back and see Malakoff again?
A. Yes.
Q. What did you say to him when you came back?
A. I said to him that I spoke to Mr. Hull; he told me that he was the principal owner of the stock in Nazareth Fair Grounds.
Q. Who was "he", Malakoff?
A. That Malakoff was. He was the president and that it would be okay to give the $5000 loan to Nazareth, and that he owns the stock, he would give it to me as collateral,

it would be okay to do that, to do the whole deal through for the $15,000.

Q. Did you on March 12, 1953 actually give Malakoff $5000?

[fol. 3026] A. Yes.

Q. Or—you did?

A. I gave to him, not five—

Q. What did you—

A. I was prepared to give him—

Q. —give him?

A. He gave me $500 on each of these three notes. That would be Wales, Ambassador and Nazareth. So he counted that as 1500. I gave him a check for 1900, which I cashed the next day in the other bank, what do you call it, Sterling Bank, because that was convenient to my house, I lived near there, and I had at that time total altogether $1600, which was a total of 5000.

Q. Where did you get the $1600?

A. I had testified at that time again I always had money with me. I made some deals with Malakoff, smaller deals, which had nothing to do with these deals.

Q. Had Malakoff given you the $1600?

A. Who?

Q. Malakoff.

A. No. I had cash from various things which—

Q. So Malakoff told you that he wanted $5000 for Nazareth Farmers Market—Nazareth Fair Grounds & Farmers [fol. 3027] Market—and you ended up by giving him or lending him $3500?

A. If he wanted to use the $1500 that way. I don't know. I should—what I should have done, maybe, is given the whole and he should have given it right back again.

Q. But he wound up with $3500 according to your testimony.

A. According to how—

Q. And gave you a $5000 note?

A. According to how he wanted it, that is how it was done.

Q. Did you get the two renewal notes and the Nazareth note from him at the same time? Was this all done at the same time?

A. Yes, that is right, yes, sir, including a paper—including a paper—which stated that it is collateral for Nazareth, Wales and Ambassador. The paper—

Q. Yes, you are referring, when you say—

A. He wrote it out himself.

Q. You say including the paper, you are referring to the original of what is Claimant Forman's Exhibit 6, is that right?

[fol. 3028] A. March 12, yes. That was it, yes, sir.

Q. Who made out the promissory notes?

A. Who made out the promissory notes?

Q. Yes.

A. Mr. Malakoff made them out. Can I see the notes?

Q. No. I want you to tell me without looking at the notes.

A. Without looking at the notes?

Q. Yes.

A. Surely, Mr. Malakoff made out the notes, it is his handwriting.

Q. He made out all three promissory notes at one time?

A. I think he did, yes.

Q. Where did he get the notes, the forms from?

A. He always had forms in his office. From his office.

Q. What is your recollection about that, did he have them on his desk? Had the notes been made out before you got there?

A. No, sir.

Q. They were made out in your presence?

A. Yes.

[fol. 3029] Q. All three notes were made out in your presence?

A. Including the paper.

Q. This paper was also made out in your presence?

A. Yes.

Q. Did Malakoff type the original of Claimant S. Forman's Exhibit 6?

A. Did he type?

Q. Did he type it?

A. I don't know what instrument he used in making up the paper. I don't remember.

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[fol. 3052] Recross examination.

By Mr. Weinstein:

Q. Mr. Forman, do you have the checks in exchange for which John Malakoff gave to you this check to the order of Seymour Forman, agent, in the sum of $2000, which has been marked Claimant S. Forman's Exhibit 16?

A. I don't remember any of the records; I told you they were lost in the moving. I would give you all the records.

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[fol. 3054] Colloquy Between Court and Counsel

Mr. Seligson: If Mr. Rosen has no objection I would like to offer in evidence the specific questions and answers that Mr. Rosen read.

The Court: But they are in the record.

Mr. Seligson: But he denied he so testified.

The Court: All right.

Mr. Seligson: That is all right, we do not have to read them, but the questions that you read.

The Court: They will be received as a Debtor's exhibit.

(Deemed marked Debtor's Exhibit E.)

The Court: They will be received in this posture: All excerpts from claimant's depositions before trial, as to which he was interrogated at the trial.

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[fol. 3069] Direct examination of Harry Forman.

By Mr. Sanders:

Q. Mr. Forman, do you have the voucher or the cancelled check which you used in purchasing the first five shares of stock in March? What date was that?

A. 1953.

Q. March, what date?

A. I think it was around March 20th.

Q. March 20, 1953?

A. Yes, I do.

Q. Will you produce that check, please?

A. (Hands paper to counsel.)

Q. Mr. Forman, I notice you produce a check of Alwin Curtain Shop in the sum of $5000 made payable to John Malakoff. Is this the check you used to purchase the five [fol. 3070] shares of stock?

A. Yes, it is.

Q. Of John Malakoff?

A. It is.

Q. Of Nazareth Market?

A. That is correct.

Q. Did you at a subsequent date return this $5000 to Alwin Curtain Shop?

A. I did.

Q. Have you the cancelled check which indicates the return of that $5000?

A. I do.

Q. Would you exhibit that, please.

A. (Witness complies.)

Q. Check dated July 15, 1953, payable to Alwin Curtain Shop, in the sum of $5000?

A. That is right.

Q. Do you now say that this check, made payable to Alwin Curtain Shop, in the sum of $5000, which you signed, is the $5000 Alwin Curtain Shop advanced on your behalf for the purchase of five shares of stock of Nazareth Market?

A. Yes. I was short in money at the time and Alwin Curtain Shop—David Hochman, the proprietor, is a friend [fol. 3071] of mine, and I asked him to loan me the money for a short period of time. And Mr. Malakoff at that time wished that the check should be drawn to him. I explained to him that I would have to get this $5000 from this friend of mine and Mr. Malakoff asked that I have this friend draw the check payable to John Malakoff so tha he could certify it and get the money immediately. He always seemed to need money.

• • • • • • •

[fol. 3078] Q. Do you remember the date in March when you had a conversation with Mr. Malakoff relative to the purchase of some five shares of stock?

A. It was around about March 15 of 1953.

Q. Let me show you a check, photostatic copy of a check No. 1423, made payable to Malakoff and signed by you, and see if this will better refresh your recollection with respect to the exact date of your conversation with Mr. Malakoff relative to the purchase of stock.

A. Yes. This was my first transaction.

Q. Will you give us the date?

A. Purchased March 20, 1953.

Q. Is that the date you had a conversation with Mr. Malakoff relative to the purchase of stock?

A. No.

[fol. 3079] Q. Or did this conversation precede, take place before that?

A. Conversation took place several days before the consummation.

Q. Will you tell us what was said, what you said to him and what he said to you relative to purchasing stock.

A. Mr. Malakoff, as I said, prior to the second purchase, he painted the picture of this Nazareth Market in very glowing terms and he told me the people were paying much more than $1200 a share for the stock, and that since he is a personal friend of mine, he would let me purchase this stock from Nazareth Corporation for $1200 a share. We finally agreed, and I purchased five shares—this was the first transaction—purchased five shares on March 20, 1953, and paid Mr. Malakoff $6000.

Q. Before you did that, Mr. Forman, will you tell us about what else Mr. Malakoff told you about the Nazareth Market and specifically with respect to dividends.

A. All right.

Q. If anything.

A. He told me two things. First, he was very reluctant [fol. 3080] to sell the stock because he knew that this stock, at least he felt, that is what he told me, that this stock would be worth a great deal of money. He is only selling it because he needed the money.

Mr. Rosen: If your Honor pleases, I have a standing objection in this case to personal conversations.

The Court: Yes, and it is overruled.

A. (Continuing) And on the occasion of the first purchase by me of these five shares Mr. Malakoff, as I said before, painted the picture very glowingly, and at that time said that he would guarantee personally that I would receive 20 per cent dividends if I would purchase these five shares of stock. I told him that it wouldn't be necessary for him to guarantee it personally; that since I was buying it from the corporation, if the corporation paid 20 per cent dividend that I will receive my share too and finally agreed to buy it.

Q. In connection with the purchase of these five shares of stock, did you have $6000 in the bank to purchase it with?

A. No.

Q. What did you do about raising that $6000?

[fol. 3081] A. I went to the Corn Exchange Bank and borrowed the money. As I said before—

Q. Wait a minute. How much money did you borrow?

A. $6000.

Q. What branch of the Corn Exchange Bank did you make that loan?

A. Astor Place branch.

Q. In connection with that loan was anything done by Mr. Malakoff and under what circumstances was that done?

A. Well, I said before that he was very reluctant to sell the stock, and when he proposed this to me, he asked me as a friend, and, remember, I told you he represented many, many clients and he helped me build a good insurance business, so I felt I owed him something. He didn't want to sell the stock, but he finally said that he would sell it to me but he would like an opportunity to buy it back. I wasn't adverse to that.

Q. What suggestion, if any, did he make?

A. Well, the suggestion we both made—he made a suggestion and we both concurred and agreed upon it. I was to borrow the $6000 in the Chemical Corn Exchange Bank. Mr. Malakoff was to assume the repayment of this $6000

[fol. 3082] at the rate of $500 a month. When he had paid back the bank the $6000, I was to give him back the stock.

Q. Were you to ask for any profit or any loss or anything like that?

A. No, the only thing he said to me, that during the interim, any dividend that would be declared for these five shares would belong to me.

Q. Did he restrict the rights of voting on that stock, if any?

A. No, no, because he said that these five shares belonged to me until such time as he will be able to repay that money.

Q. Now, Mr. Forman, have you the check of $6000 which was used for the purchase of the five shares of stock you have just referred to?

A. This is a photostatic copy of it.

Mr. Sanders: I offer the check in evidence.

Mr. Rosen: The only objection I have is it is not binding on the debtor corporation, not made out to the debtor corporation, and has no notation of any kind or endorsement or otherwise of the debtor having received it.

The Court: Overruled.

[fol. 3083] Mr. Seligson: No objection.

(Marked Claimant H. Forman's Exhibit 7 in evidence.)

Direct examination.

By the Court:

Q. Mr. Forman, this Claimant's Exhibit 7 is dated March 20, 1953, and appears to be a check drawn by you on your account at the Corn Exchange Bank and Trust Company, at Astor Place, for $6000 to John Malakoff. Did I understand you to say that this $6000 emanated from a loan which you made from the Corn Exchange Bank and Trust Company?

A. Yes, your Honor. The proceeds of that loan is that $6000.

Q. When did you make the loan? When was the loan credited to your account?

A. The loan—I have it right here, March 20, 1953, your Honor.

• • • • • • •

[fol. 3085] Direct examination.

By Mr. Sanders:

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Q. The five shares of stock, marked Exhibit 5, is that the five shares of stock that were delivered to you for the $6000? The certificate is marked as March 1953.

A. Yes, this is the one.

The Court: When you are through with that, may I see it again?

Mr. Forman, I address your attention to the fact that the certificate itself, on its face, is dated March 13, 1953, but the assignment on the reverse side thereof, purportedly to you and signed by Malakoff is dated March 17, 1953. With these dates in mind, can you tell us, if you do recall, when it was that this certificate actually came into your possession, and where, and from whom, and what were the other circumstances surrounding it.

• • • • • • •

[fol. 3087] The Witness: I took these 12 notes of $500 each to the bank on March the 17th. The bank thereupon started the wheels in motion to put through the loan of $6000.

The Court: Let me ask you this, did the bank discount Malakoff's notes on your endorsement?

The Witness: Yes, sir.

The Court: Or did they make an independent loan to you and merely accept Malakoff's notes for collection?

The Witness: They made the loan on the basis of his notes, which they discounted, which they discounted for me on my signature.

[fol. 3088] The Court: I see.

Q. Did Mr. Malakoff have an account in that bank?

A. No.

Q. Could Mr. Malakoff loan a nickel from the bank on his notes?

Mr. Seligson: Your Honor—

The Court: Just a moment, just a moment. The objection is sustained. But, in any event, my recollection is that most of the Malakoff checks were drawn on the Corn Exchange Bank. So, when you say bank, maybe you mean branch.

Q. The branch at which you made the loan of the $6000.

A. He was unknown there.

Mr. Seligson: One minute. What is the question?

The Court: Merely whether Malakoff had an account in the Astor Place branch.

Q. Your answer?

A. He was unknown there.

Q. Is it your testimony the $6000 that was credited to your account was a loan based on your signature all alone?

A. Only on my signature.

• • • • • • •

[fol. 3091] A. Good. I pointed out before that Mr. Malakoff was reluctant to sell that stock. He and I figured out a way how he could sell me the stock and yet, after a year's time, he could get that stock back. The way we both figured it out was that way. He was to draw these 12 notes, I was to take them to the bank, discount them, get the $6000, give him the $6000, give him the opportunity to repay this money at the rate of $500 a month and, if he did, he was to get the stock back and I did not own it, but our understanding was that I was buying this stock at that time.

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[fol. 3097] Cross examination.

By Mr. Rosen:

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A. No. I have the evidence here to show that I made the loan, if you would like to see it.

Q. Yes, sir, if you have.

A. That I made the loan, and not Mr. Malakoff.

Q. Kindly produce it.

A. All right. Here is the original note which I signed for the loan for the Chemical Corn Exchange Bank to show that I made the loan and not Mr. Malakoff.

• • • • • • •

[fol. 3098] The Court: As I construe the document, he went in and he borrowed $6000 and he put Malakoff's notes up as "Collateral security." He gave his note for $6000 to the Corn Exchange Bank and he put up the Malakoff 12 notes as "collateral security." And you are asking this layman whether that constituted a guarantee or some other sort of transaction.

Q. Was it your understanding that you were guaranteeing the payment of these notes?

A. No, I didn't guarantee the payment at that time. I knew that shouldn't he pay I would have to pay. I was making the loan. I knew that.

• • • • • • •

[fol. 3106] Q. I show you Claimant H. Forman's Exhibit 6 and ask you, doesn't that stock on its face first show that it was issued at John Malakoff and then transferred to you?

A. That is correct.

Q. Did you see that when you received the stock certificate?

A. Yes, I did.

Q. Did you make any comment about it?

[fol. 3107] A. None whatsoever.

Q. Similarly, Claimant H. Forman's 5, you note that that stock certificate bears the notation that it was first issued to John Malakoff and then purportedly transferred to you; is that correct?

A. That is correct.

• • • • • • •

[fol. 3109] Q. When you made out your checks, you made them out to John Malakoff personally and when you received Claimant's Exhibits 5 and 6 and saw that they were

in the name of John Malakoff originally, did you make any investigation to ascertain whether these certificates were properly issued and the consideration paid to the corporation?

A. I didn't think it was necessary.

Q. Was there any agreement between you and John Malakoff that if he repaid the $5000 on this Alwin Curtain Shop situation that John Malakoff would also receive back Claimant H. Forman's Exhibit 6?

A. No.

• • • • • • •

[fol. 3197] Direct examination of
Herbert Danciger.

By Mr. Franklin:

Q. Thereafter did anything transpire with reference to this leasehold and the representations that John Malakoff had made to you?

A. Yes.

Q. Will you please tell the court what happened in that [fol. 3198] regard?

A. Rents did not come in like they were supposed to through the mail when they were due. I also learned that the rents actually being paid were not as represented and what they were supposed to be. I also learned that some of the tenants were ready to move out because they could not even remain in business or pay the rent, whatever they were. I also found that in order to try to get the rents, instead of them coming through the mail you would have to go chasing after the tenants to collect them. I also found I believe that taxes were in arrears rather than being paid up to date.

As I recall all these things added up to nothing like he originally stated this was.

• • • • • • •

[fol. 3200] Finally he said, look I will buy it back from you at exactly w at it cost me. I said, fair enough. He then said to me but he does not have the money to pay for it, he would give me immediately—he would give me—

Q. Do you want to refresh your recollection?

A. I think it was a check. Yes, a check. And he paid for the repurchase of this property with a payment of 12 post-dated checks.

Q Totaling how much, Mr. Danciger?

A. Totaling about—well, about $12,000.

Q. About $12,000?

A. About $12,000.

Q. Mr. Danciger, I show you an agreement dated the 18th day of March, 1953, between Herbert Danciger and Melvin F. Danciger and John Malakoff, and signed at the end thereof by John Malakoff and Herbert Danciger (handing to witness), and ask you if this is the agreement to repurchase your interest in the Roslyn Heights property?

A. Yes.

• • • • • • •

[fol. 3201] Q. When you deposited the first check what happened?

A. It was returned, account closed.

Q. Do you recall approximately when that check was dated?

A. April 18, 1953.

Q. What did you do when this first check was returned?

A. I immediately contacted Malakoff and apprised him of the situation, and I went to see him.

Q. And what did he say to you and what did you say to him?

A. Well, he told me that he had closed the account for business reasons and had opened it in another bank, and that he would give me in exchange for checks what he called accelerated notes on the new bank where he had opened an account.

Q. When was the first note of this new series of notes payable?

A. I believe it was a few days later, the first one due April 22nd.

[fol. 3202] Q. Did you deposit that note?

A. I did.

Q. What happened when you deposited that note?

A. It was returned insufficient funds.

Q. Did you speak with John Malakoff concerning this?

A. I immediately went to see him and told him I was going to take advantage of the acceleration notes and demand everything with all the notes. So at his insistence he gave me a check to replace the first note, which came back insufficient, and gave me 11 shares of—he gave me I think it was 11 shares of stock as collateral in the Nazareth Corporation for the balance of the notes.

Q. The balance of those notes were $10,946.97; is that right?

A. Yes.

• • • • • • •

[fol. 3230] Cross examination.

By Mr. Rosen:

Q. I show you Claimant Danciger's Exhibit 12 and, irrespective of your remembering the exact date, in so far as the sequence of events that you have testified to, will you kindly tell me when you received Claimant Danciger's Exhibit 11? Tie it in with the particular event that you have spoken of.

A. When or how, is your question now? Because in the beginning of your question you said "not remembering the exact date".

Q. I said, with the event.

A. With the event I can tell you. When Mr. Malakoff replaced the checks on the bank—his account was closed—with notes, accelerated notes, the first note, upon presentation, came back marked "insufficient funds." I saw him about this. I believe he visited the bank with me to make it good. We returned to his office. I don't recollect now whether it was upon his giving me the notes originally or after the first note had come back marked "insufficient funds" that I told him that I was going to take advantage of the acceleration clause in the notes, that he gave me this [fol. 3231] stock certificate as collateral for the notes.

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[fol. 3386] Cross examination of
Harry Forman, resumed.

By Mr. Seligson:

Q. What does it say?

A. It says "Corn Exchange Bank, first payment of 5000 loan Hochman," which to me means the first payment that I made to the Corn Exchange Bank towards the $5,000 loan which I took from Hochman.

By the Court:

Q. You borrowed $5,000 from Hochman and you paid it back by paying the Corn Exchange Bank?

A. No. I borrowed $5,000 from Hochman and then borrowed $5,000 from the bank and repaid it to Hochman in one lump sum, and then returned it to the bank at the rate of $250 a month, and indicated on the stub that this $250 that I was paying back on that $5,000 loan was to Hochman, $5,000.

Q. Well, now, will you look at Claimant's Exhibit 4, please.

(Exhibit is handed to the witness.)

Q. That is the check, is it not, for $5,000 dated July 15, 1953 from you to Hochman's company, the Alwin Cur-
[fol. 3387] tain Shop?

A. That's right.

Q. Is that the repayment that you spoke of?

A. Yes, sir.

• • • • • • •

[fol. 3674] Cross examination of
Arnold A. Weinstein, resumed.

By the Court:

Q. Mr. Weinstein, so long as we are speaking of impressions, as a lawyer who drew that agreement, can you
[fol. 3675] give me an idea of what impression you think somebody might get reading the second paragraph? Notice the second paragraph of that document.

A. I would say, your Honor, that if anybody read this second paragraph standing alone he would not be receiving a proper understanding of the document. I think that in order to understand the second paragraph, as your Honor points out, I think it would be necessary to read the entire Claimant's 4—3, rather.

Q. Mr. Weinstein, I think you understand me. Leaving out the fact that there was indecision at that time as to what future form the enterprise would take, I ask you as a lawyer who drew that document what you believe any reasonable person would get, what impression they would get, as to the ownership of a venture by reading the second paragraph in the language that you coined.

A. The impression that somebody would get, your Honor, is that John Malakoff had had all of the stock issued to him and that he owned it.

Q. And that he was selling it, is that right, in some form?

A. Yes, sir.

Q. But am I to understand your testimony to be that, [fol. 3676] notwithstanding the employment of that language in that agreement, the impression that you got from John Malakoff was different?

A. Yes, sir.

• • • • • • •

[fol. 3681] Cross examination.

By Mr. Ros n:

Q. Yet you tell the Court of impressions that you had that this was a promotion and John Malakoff, in fact, in real fact, did not own all the stock but this was merely a modus operandi to carry through a promotion, is that true?

A. The check—yes and no—the check was made payable to John Malakoff because I didn't know at that time that I was definitely buying any corporate stock at that time. The chances were one way or another. I may have been buying corporate stock on the one hand; on the other hand I may not have been buying any interest in a corporation at all but, rather, one in a limited partnership.

• • • • • • •

[fol. 3684] Q. Who suggested—who raised the first issue about how this venture was to be operated?

A. John Malakoff did.

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[fol. 3690] Q. Am I to understand, Mr. Weinstein, that when you prepared Claimant Weinstein's Exhibit 3 you were representing John Malakoff; you owned no stock in this corporation; you were endeavoring to protect John Malakoff as your client?

A. Representation is a difficult word. I have outlined the basis upon which I drew that exhibit. It was based upon information that he gave me and represented an attempt to accommodate to a dichotomous situation.

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[fol. 3692] Q. Were you asked these questions and did you give these answers:

"Q. Did Mr. Malakoff tell you he was selling you stock that had been issued by the Nazareth Fair Grounds & Farmers Market, Inc. or that he was selling you original issue of corporate stock?

"A. He said neither.

"Q. What did he say that he was selling you?

"A. He was selling an interest in this venture in Nazareth, and the form of the investment was left substantially up in the air pending a determination as to whether or not the best way to be conducted, in the form of a corporation or a limited partnership."

A. I said that.

Q. Is that true, according to your present recollection?

A. Yes.

Q. Are you testifying that statement is true notwithstanding the statements in Claimant Weinstein's Exhibit 3 and Claimant Weinstein's Exhibit 6, in which purportedly [fol. 3693] it says that all of the stock is issued to John Malakoff?

A. That is correct.

Q. Was it your understanding that Mr. Malakoff was to keep these moneys that you gave him, the sum of $7,000?

A. No, sir.

Q. What was your understanding?

A. My understanding was that this was supposed to be used in the venture itself, for the venture itself; that I was not giving this money to John Malakoff personally.

Q. Have you ever done any work for John Malakoff, Nazareth Fair Grounds & Farmers Market, Inc. or any firm connected with John Malakoff or Helen Bernstein, other than what you have testified to?

A. No.

Q. Have you had any kind of transactions of any nature or nature with Helen Bernstein or John Malakoff other than what you testified to?

A. No.

• • • • • • •

[fol. 3706] Cross examination.

By Mr. Robbins:

Q. Do you remember whether you talked about this form of organization of the venture with John Malakoff and [fol. 3707] whether John Malakoff told you anything about what his knowledge of various forms of real estate ventures was?

A. He told me in substance that he had received some advice, that the advice revolved around a particular method of operation which would be best suited under all of the circumstances, that it was a question of operating this thing through a corporation or through a partnership or limited partnership or something of that nature. And when he started the conversation off with that I recall that I interpolated something to the effect that obviously in the case of a partnership or a limited partnership he would avoid the impact of double taxation in the form of a corporation.

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[fol. 3712] Q. What you did was to draft this letter.

A. That is right.

Q. If I understand you, are saying that you had no responsibility and, for that matter, no interest in the form

that the organization would take in the future or the form it was in even at that time.

A. At the time that I drew that letter I had no interest at all.

Q. You were simply serving as a draftsman based on [fol. 3713] certain information and concepts that were given to you by John Malakoff?

A. That is right, and also concepts that I developed as a consequence of the conversation.

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[fol. 3775] Cross examination.

By Mr. Seligson:

Q. Now in the course of your conversation with Malakoff about the advantages of a corporation and a partnership, weren't you told that a corporation known as Nazareth Fair Grounds & Farmers Market, Inc. had been organized?

A. He mentioned the name of a Nazareth corporation. I made no notation of it. But I do recall that I translated that on to my proposed draft as the name that appears on it, Nazareth Farmers & Auction Market, or something to that effect.

Q. Did he tell you that he was the sole stockholder in this corporation?

[fol. 3776] A. He did not. He indicated to me, and I think I am rather certain about this, he indicated to me that the stock was going to be issued to him because he did not want to get the SEC on his neck in the event that he gave these stock certificates to so many different people.

Q. Didn't he tell you that he had been selling participation interests in this market to other people?

A. He mentioned that he had sold interests to other people.

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[fol. 3844] ESKANDER MANOOCHEHRIAN, called as a witness in his own behalf, being first duly sworn, testified as follows:

Direct examination.

By Mr. Sidney Bush:

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[fol. 3848] A. Yes, on November 14, 1952 I had some discussion with Malakoff in regards to a deed that he had bought or he was buying on 69th Street, a piece of property on the East Side, and he told me at that time that if I give him $20,000 that it will make the deal very much [fol. 3849] possible and that he will be put me in this deal for my money.

At that time, he give me this. I agreed to give him the $20,000 but he owed me $5,000 from the previous $10,000. He came down from his office with me. We went forth to the Irving Trust Company, at which place I had my bank account, and I believe he had—he took a $5,000 check, gave me right in there. I put it in my account. That made it possible for me to give him a $20,000 check.

Q. Is this the check drawn on your account, the Irving Trust Company, to the order of Wales Properties, Inc. dated November 14, 1952?

A. Yes, sir.

Q. Which you spoke of?

A. Yes.

• • • • • • •

[fol. 3851] Q. On December 10th did you have a meeting with Mr. Malakoff and discuss with him the repayment of the $20,000 and then did you come to some understanding which is evidenced by this memorandum?

A. Yes, I did. I met with him and I arranged with him to pay my money back in, I believe, seven installments of $2,857.14.

Q. Did Mr. Malakoff give you a memorandum?

A. He did.

Q. Is that his signature?

A. Yes.

• • • • • • •

[fol. 3852] Q. Mr. Manoochehrian, did you receive any of these weekly payments mentioned in this last exhibit?

A. I received two of the payments.

Mr. Seligson: How many?

Q. Will you tell us when—

The Witness: Two of the payments.

Q. Will you tell us when and in what amount?

A. One was December 1, 1952 for the sum of $2,857.14.

The Court: Wait a minute. The agreement was dated December 10.

Q. You have before you some other documents, if you have any doubt. Look at your records, please.

A. Just a moment.

December 17, the first one was $2,857.14, December [fol. 3853] 17.

Excuse me for the—

The Court: That's all right.

A. (Continuing) And the second one was December 26, $2,857.14.

Q. Did you receive any of the other payments?

A. I did not.

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[fol. 3854] The Court: Oh, I see. All right, you go ahead now. Now we know you are holding a series of checks and two of them were deposited. The first and second ones of them cleared?

The Witness: Yes, sir.

The Court: When you were about to deposit the third one, he called you up?

The Witness: Yes, sir, and he said not to deposit it, that there is no money. At the time I went back and forth [fol. 3855] to him and there was no use, he didn't have the money, and he told me not to put the money in.

Q. Put the checks in, you mean?

A. Not to put the checks in. I became worried about my money and—

Q. Did the subject of the Nazareth Fair Grounds & Farmers Market arise at that point?

A. Yes.

Q. About when was this?

A. I believe that it was some time in the beginning of '53, where he told me that he has the Nazareth Fair Grounds & Farmers Market, of which I had heard before, and that he would like, instead of my balance of my money, to give me shares of this thing that he owns.

• • • • • • •

[fol. 3858] Q. Will you tell us the substance of the conversation, if you recall?

A. The substance is that he did not have any money and that he would want to give me stocks of Nazareth Fair Grounds and Farmers Market instead of my money. And there were—he kept telling me that the stocks were being transacted for $1,000 apiece. I did not question it at the time. And finally it resulted in his giving me 14 shares of stock.

Q. I show you this stock certificate No. 36 for 14 shares dated February 2, 1953 and ask if this is the certificate he delivered to you?

[fol. 3859] A. This is it, sir.

• • • • • • • •

[fol. 3968] Cross examination.

By Mr. Rosen:

Q. I show you three checks, one dated November 6th, the other November 12, the other November 14. The November 6th check was for $2,500, to Eskander Manoochehrian, signed John Malakoff; check of November 12, $2,500, to Eskander Manoochehrian, signed John Malakoff, agent—both are "agent"—and another check dated November 14, 1952 for $33.33, signed John Malakoff, agent, and ask you whether you received these three checks?

A. I did.

Q. And you received the moneys therefrom?

A. Yes.

• • • • • • •

[fol. 3990] A. Malakoff gave me that in April when I received the six shares and for his own reason put that date of the 14th of November. I received that paper—

Q. Did he tell you the reason why he put November 14, 1952 in April?

A. He did not; I don't recall having heard it.

Q. Have you had this receipt in your possession—I am talking of Claimant Manoochehrian 10—in your possession from the time you received it until the present time?

A. From the time I received it.

Q. There was no change made by you or anybody on this receipt from the time you received it, was there?

A. Definitely not by me.

Q. And you claim that this receipt—

The Court: May I interrupt a moment?

Mr. Rosen: Surely.

Cross examination.

By the Court:

Q. Do you have a recollection as to which bank you went to when this transaction took place, Mr. Manoochehrian?

[fol. 3991] A. Which transaction, sir?

Q. Where he gave you the $5,000?

A. Yes, the Irving Trust Company.

Q. The Irving Trust Company?

A. Yes, sir.

Q. And that was—

A. On November 14th, he came down with me.

Q. You see, I told you not to volunteer information and now you do.

A. I am sorry.

Q. Was it November 14th or was it April?

A. When he came down and paid the $5,000 in the bank was November. When I made the loan to Malakoff, the $20,000 loan.

Q. Then it was in April that you got the stock certificates?

A. Yes.

Q. And it was in April that you claim you got the letter—

Mr. Rosen: Claimant Manoochehrian 10, your Honor?

The Court: Claimant Manoochehrian 10, despite the fact that it was dated November 14, 1952.

The Witness: Yes, sir.

• • • • • • •

[fol. 3993] Cross examination.

By Mr. Rosen:

Q. The difference between the $16,000, which is the receipt that you got from John Malakoff, and the 14,285.82 which you claim was the actual balance due, what was that, a bonus?

Mr. Bush: Objection, your Honor.

The Court: Overruled.

A. I frankly, Mr. Rosen, do not recall. This paper was given to me by Malakoff. There was no question of bonus there, and I have testified to that before.

Q. Mr. Manoochehrian, we have it that there was only due you 14,285.82, is that correct?

A. That is correct.

Q. And you took and accepted a receipt and kept the receipt from John Malakoff for $16,000, is that correct?

A. He made this thing and gave it to me.

Q. I say you received it, accepted it, you didn't ask that [fol. 3994] it be corrected, amended or changed; isn't that so?

A. (Witness nods head.)

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[fol. 4913] Frederick Katzenell, called as a witness in his own behalf, being first duly sworn, testified as follows:

Direct examination.

By Mr. Robbins:

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[fol. 4915] Mr. Robbins: Your Honor, at this point, before proceeding further, I would like to explain the proce-

dure that I want to follow in this case, subject, of course, to the Court's approval.

Mr. Katzenell's claim to the Nazareth stock rises from an agreement with John Malakoff on September 4, 1951 whereby he acquired 50 shares of stock at that time for $30,000. Most of the $30,000 represented an antecedent debt which we intend to prove, and I would like to offer a [fol. 4916] stock certificate and—to offer the stock certificates and this basic letter and check at this point, and then prove what lies behind it in chronological order up to September 4, if I may.

• • • • • • •

[fol. 4918] Q. Now, Mr. Katzenell, this letter refers to receipt of $30,000 by John Malakoff from you. Did you give John Malakoff $30,000?

A. Yes, sir.

Q. When did you give him the money?

A. On September 4, 1951 I gave him a check for a balance of $2,000 which he marked, balance, total received $30,000. Previously I had dealings with him and the moneys which I had invested with him he did not repay me, but he had it with him. So it piled up the amount up to this amount.

Q. All right. In other words, you are saying that you gave him $2,000 on September 4 and he owed you an additional $28,000 at that time?

• • • • • • •

[fol. 4981] Q. What happened next on this deal, Mr. Katzenell?

A. And the deal was actually bought by—the deal was bought and it was bought in my name.

Q. Were you present at that closing?

A. I was only present at the time when the contract was signed.

Q. Where was it signed and when?

A. It was signed, I think, in January, some time in January, 1951, and it was in the office of Mr. Liebowitz, Jacques Leibowitz, because his sons were the sellers, and I give at that time—I gave a check for $2,500 to Mr. Bernard Mar-
[fol. 4982] golis, for $2,500, and I had a 50 per cent in-

terest in this contract, because there was 7000 put up on contract, a thousand dollars which I paid previously and the $2,500, which makes $3,500, and the total deposit on contract was $7,000, but if I recall well, Mr. Margolis, who was the attorney on this—

Q. This check is drawn to the order of Bernarold Margolis. Is that your handwriting?

A. That is right. At that time—

Q. Who was Bernard Margolis?

A. I, at that time, I didn't know Mr. Benjamin or Bernard, because I didn't know Mr. Margolis. I only know him once or twice. So I made the name Bernard Margolis.

• • • • • • •

[fol. 4984] Q. Of the payees?

A. That is what I said before. One is Robert Leibowitz and Lawrence Leibowitz for $6,000. One is Hampton Homes, Inc. for $1,000, totaling $7,000. That was the amount paid on deposit for this deal.

Q. Do you know who the principals were in Hampton Homes, Inc.?

A. Yes. It was the corporation of Mr. Robert and Lawrence Leibowitz.

• • • • • • •

[fol. 4986] Q. Do you know anything about these checks? Do you remember anything about these checks that you signed?

A. I remember that it was the return of $7,000. $7,000.

Q. Yes.

A. And then there was a check for profit which I don't know, I don't recall, $10,000, $12,000 or $14,000.

• • • • • • •

[fol. 4987] Q. What was the conversation?

[fol. 4988] A. He told me to leave the money with him.

Q. Yes.

A. For future deals. He said, "You don't need the money, I know, Fred. You have enough money and you made a profit with me already and you know I am honest and I don't run away."

I say, "It is all right, John, whatever you want, you will give it to me." I had full confidence.

Q. When if ever did you get a return on this Blossom and Saul deal in your hands?

A. September 4 when I purchased a quarter interest in the Nazareth Market; all those amounts due to me, which I had in a small notebook, I sit down and figure out everything what was due me, and I take the balance and so we wipe out—

Mr. Rosen: If your Honor please, I move to strike out all this story of what was said. That isn't the question.

(Last question read.)

The Court: Will you answer that, please? When did you get back the $3500 from the Blossom and Saul deal?

The Witness: It has been adjusted to purchase stock [fol. 4989] in Nazareth Market.

Q. That would be on September 4?

A. Yes.

• • • • • • •

[fol. 5009] Q. Incidentally, Mr. Katzenell, do you have any record in that book that we have marked Exhibit 7 or elsewhere as to your profit in this transaction, the Clifton transaction?

A. No, I don't have.

Q. This is just your own recollection?

A. Because in 1950—

Q. Never mind because.

The Court: Just answer the question. You are basing it on your recollection, is that right?

The Witness: That is right.

Q. Let me ask you one more thing, Mr. Katzenell: There is another check here dated May 23, 1951, which has something on the back, Clifton deal. Whose handwriting is that Clifton deal?

A. That is my handwriting.

Q. Now, is this check related to this Clifton transaction you have been describing and to the check dated January 24, 1951, which we have marked Exhibit 30?

A. No, that was a different Clifton deal.

• • • • • • •

[fol. 5110] Q. Suppose I were to tell you, Mr. Katzenell, that Mr. Kanter had testified that he received some money back on the East 3rd Street deal. Would that make any difference in your testimony?

A. I don't see that I got any money. I can't. What another business has done, on another participant, it doesn't apply to me.

• • • • • • •

[fol. 5111] The Witness: I say, I do not see that I have ever received any money back on this 3rd Street deal; what another participant has done or received doesn't necessarily apply to me.

Q. Mr. Katzenell, I want to show you a check which is dated September 25, 1951 and is a part of an exhibit which was received in the Charles Kanter claim as Debtor's Exhibit E. This is a check in the sum of $1609.50.

A. Yes.

Q. By John Malakoff to Charles Kanter.

A. Yes.

Q. Now, do your records indicate any receipt by you of a similar amount on a similar date from John Malakoff?

A. Yes. I have a deposit slip showing that I received $1609.50.

Q. When?

A. On September 25, 1951.

Q. From John Malakoff?

A. Yes.

• • • • • • •

[fol. 5225] Q. Mr. Katzenell, you were saying something about December 15, 1950.

A. Yes.

Q. What was that?

A. December 15, I had through a friend of mine procured $7500 for Mr. Malakoff.

• • • • • • •

[fol. 5232] Mr. Robbins: I offer this check in evidence, your Honor.

The Court: Now, wait a minute. Whose check is it?

Mr. Robbins: It is from Simon Rosenkranz to John Malakoff.

The Court: Well, how does that become his transaction without proof?

Mr. Robbins: All right.

The Court: I am not going to take that in evidence. It is a third party altogether. There is no connection between them so far.

Mr. Robbins: All right.

The Court: Who is Simon Rosenkranz?

The Witness: Simon Rosenkranz is a friend of mine.

• • • • • • •

[fol. 5246] Q. Well, did you get that money back, Mr. Katzenell, the $5000?

A. No.

Q. Did you receive any part back?

A. No. It had been applied to—later on I purchased the property.

[fol. 5247] Q. You purchased what property?

A. Ocean Parkway.

Q. Now, you say this $5000 was applied to the purchase of the Ocean Parkway property?

A. Yes.

Q. And not to the Nazareth deal, is that right?

A. That is right.

• • • • • • •

[fol. 5299] Q. Were there any further advances by you to John Malakoff or Helen Rothschild on the Ocean Parkway deal?

A. I just see a small check there for $150 or $151 on July 10 to John Malakoff for some adjustment on Ocean Parkway.

• • • • • • •

[fol. 5329] Direct examination.

By the Court:

Q. What happened?

A. In September 1952 I had been called to the District Attorney's office.

Q. What District Attorney's office, New York County?

A. New York County.

Q. Yes.

A. And I had been questioned there—

Q. Yes.

A. —regarding some—regarding the property on Ocean Parkway, how I acquired the property on Ocean Parkway, from whom and how I paid for it. I brought all the documents up to the District Attorney's office. He checked it. But it was already in August—when I had been there—it was just a month later—a month later—that I sold it. I had it already sold.

Q. Just a minute. You had been where in August?

A. In August I had been, on the 29th of August, I had been to the office of the District Attorney.

[fol. 5330] Q. I thought you just told me it was in September you went to the District Attorney?

A. I have here—

Q. All right. Let us start from the beginning. What happened in August? You went to the District Attorney what time in August?

A. August 29, 1952.

Q. During the month of August you got $500 from Malakoff, didn't you?

A. Yes.

Q. You say that in September, after you visited the District Attorney's office, you had a conversation with Malakoff?

A. In September?

Q. Yes.

A. Yes. In the beginning of September.

Q. In the beginning of September. Where?

A. In his office.

Q. What did he say and what did you say? Who was present?

A. Mr. Malakoff and Miss Bernstein.

Q. What was said?

A. Can I not continue what I wanted to say?

Q. No, you will answer my question. What was said at [fol. 5331] the conference in September, the early part of September?

A. That he has—he has given me a check for the dividend

and I should not be afraid; what I heard in the District Attorney's, this is not so. He tried, because I had some fears, and I expressed those fears—

• • • • • • •

[fol. 5415] Direct examination.

By Mr. Robbins:

Q. Did John Malakoff ever tell you what the total return was on the investment in the Blossom & Saul deal?

A. He told me that the profit was $9,000, and the investment, the return, the money deposited on the contract was $7,000, and the profit was supposed to be $9,000. Nine and seven would be sixteen. I see it is 19 here, which I have been cheated.

Q. Well, John Malakoff said that the return was $9,000?

A. The profit.

Q. The profit, rather.

A. Yes.

Q. And what was your share of that profit?

A. 50 per cent.

Q. Did he say?

A. 50 per cent.

Q. So you were entitled $4500 profit plus the return [fol. 5416] of your $3500?

A. Right.

• • • • • • •

[fol. 5454] Cross examination.

By Mr. Rosen:

Q. When you were testifying on pretrial examination on September 2, 1958 were you asked these questions and did you give these answers, page 5:

"Q. Are you testifying from a book and record?

"A. From my memory and from the book. I'm helping myself if I can't—

"Q. Is this book and record that you are refreshing your recollection from—

"A. Old.

"Q. —a record kept in the regular course of your business?

"A. Please, will you ask me again? I can't follow.

"Q. Is this book and record a record that you kept in the regular course of your business?

"A. At that time, yes, I kept it.

"Q. Was this the book you were speaking of when you were being examined before trial by me? I am talking of Claimant's 7?

"A. Yes, Mr. Rosen.

"Q. It was in your own handwriting that you kept it?

[fol. 5455] "A. That's right.

"Q. From day to day, week to week, month to month and year to year?

"A. I kept it only with Malakoff, with, say, for the beginning of my transactions. Then, when I trusted him, I just didn't continue to keep records.

"Q. Can you let me have the book, please?

"A. Sure.

"Mr. Rosen: I ask that this book be marked for identification, please.

"(Ledger book marked Debtor's Exhibit 1 for identification.)"

And this ledger book marked Debtor's Exhibit 1 is presently Claimant's Katzenell Exhibit 7, correct?

A. Yes.

Q. "The Witness: This is something which is not pertinent to this business.

"Mr. Rosen: Off the record.

"(Discussion off the record.)

Q. "Q. I show you Debtor's Exhibit 1 marked for identification and ask you whether except for Debtor's Exhibit 1 for identification did you keep any other books and rec-

[fol. 5456] ords or ledgers as to your transactions?

"A. No."

Were you asked those questions and did you give those answers?

A. I don't recall, Mr. Rosen. I don't remember.

Q. I said, were you asked those questions and did you give those answers?

A. I don't know.

Mr. Rosen: If your Honor please, may I please mark into the record the pretrial examination, the questions and answers that I have—

The Court: You have already got them in the record, Mr. Rosen. How else do you want to mark them?

Mr. Rosen: The witness testified he doesn't know, I want to show they are actually part of the record.

The Court: That you have already read them into the record.

Mr. Rosen: And that I have read them correctly.

The Court: Well, I don't know whether you have or not. [fol. 5457] I assume that as a member of the Bar of this court you wouldn't deliberately misread anything.

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[fol. 5467] Q. Now, on the examination of Mr. Menin that I referred to again, on the question of this book, on page 78 were you asked by Mr. Menin the following questions:

"Q. Now, let's stop here for a minute. Will your books indicate that you paid Malakoff $30,000—

"A. Yes.

"Q. —for the Nazareth stock?

"A. That is right.

"Q. Your books will show that?

"A. And if it doesn't show, I will make that for you."

Were you asked those questions and did you give those answers?

A. Yes.

• • • • • • •

[fol. 5503] Q. Yes, sir. Now, Mr. Katzenell, you gave Mr. Malakoff $750 by Claimant's check, Claimant's 84, on September 19th, 1950; correct?

A. Yes.

Q. And you have produced a note in court; Claimant Katzenell's 85, dated September 25, payable November 30, 1950, for a thousand dollars, is that correct? Is that right?

A. I beg your pardon? Pardon? You said I have produced a check for 750?

Q. That is right, sir. And a note, Claimant Katzenell's 85, for a thousand dollars.

A. Yes. This has nothing to do with me, this thousand [fol. 5504] dollars. And this $750 that must reflect here somewhere. Let me find it out. 750—and it says, referring—

Q. There is nothing here about the 750. The 750 merely shows money given and paid back. There is nothing here on this note of a thousand dollars, is that correct?

A. That says nothing.

Q. There is nothing here on this item, 750?

A. It doesn't say.

Q. But you received this note from Mr. Malakoff to your own order for a thousand dollars?

A. Yes.

Q. And I am referring to Claimant Katzenell's 85.

A. 85, yes.

Q. This note was in payment of the $750 for which had no notation of what it was for—

A. No.

Q. —which you gave on—

A. No.

Q. —on September 19th?

A. At that time, at that time definitely I did not give $750 for something which I did not know what it is for and [fol. 5505] I received this note. This note is for something else which Mr.—when I gave it to Mr. Rosenkranz, then Mr. Rosenkranz must have given the money for that.

Q. No, Mr. Katzenell. The note was given to you.

A. Yes.

Q. Not to Mr. Rosenkranz.

A. Mr. Rosenkranz didn't—

Q. I say, the note was given to you.

A. That is right.

Q. Didn't you testify that you received this note from Mr. Malakoff for money that you gave him and that you discounted this note with Mr. Rosenkranz?

A. I don't think so.

Q. Mr. Katzenell, did you get $250 interest from Mr. Malakoff on the $750 item that you gave him?

A. Definitely no.

Q. You don't know what the $750 you gave him was for?

A. If it doesn't say on the check, I don't know.

Q. And you don't know what you received this note, Claimant Katzenell's 85, for?

[fol. 5506] A. I have a faint idea, but you want to have another certainty so therefore I can say no. But if you allow me to express my view then I can tell you.

Q. Is it merely opinion—

A. Opinion.

Q. —or knowledge?

A. An opinion, not knowledge, not a hundred per cent.

Q. So you don't know what you received this note—

A. Definitely no.

Q. —Claimant's 85 for?

A. I definitely know that it was only to Mr. Rosenkranz for something which he has given to me to give to Mr. Malakoff and for which I brought him back a note.

Q. Mr. Katzenell, have you testified in this court that Mr. Rosenkranz merely acted, and when I say "this court" I am not talking about this trial—

A. Yes.

Q. —that Mr. Rosenkranz merely acted as your agent and your dummy and that all the money that Mr. Rosenkranz gave to Mr. Malakoff came from you?

[fol. 5507] A. A hundred per cent not true.

Q. You did not so testify?

A. I did not so testify. And in the pretrial examination you said so, if it is true, and I say no, which I have afterwards proven that it is not so.

Mr. Rosen: Will your Honor excuse me just for a moment, please.

Q. On page 274 were you asked the following questions on your direct examination, held on September 8th, 1958:

"Q. Wasn't Mr. Rosenkranz merely a dummy for you, just to handle your transactions? He has no money of his own, really, to pay out and loan; is that correct?

"A. No, he is a wealthy man, but he acted in 1952, he acted for me because he collected $3600 which I owed him, not Mr. Malakoff, he collected it for me, or he advanced me money.

"Q. You mean Mr. Rosenkranz gave you money for the note for $3600?

"A. Yes.

"Q. As a matter of fact, he gave you—

[fol. 5508] "A. No, after he collected it he gave it to me.

"Q. So that wherever Mr. Rosenkranz's name appears and your name appears on any one of your transactions, that was a situation where Mr. Rosenkranz acted as a dummy for you?

"A. I wouldn't call it as a dummy. He has done me a favor.

"Q. The word 'dummy' means somebody is merely acting for you?

"A. Oh, I see. Yes, sir, it is correct."

A. It is correct.

Q. Were those questions asked and did you give those answers?

A. But—

Mr. Robbins: Objection.

A. But it has a completely different meaning.

The Court: Strike out the answer.

(To Mr. Robbins) Why?

Mr. Robbins: All this testimony seems to refer to the note of 1952 and not the note that we were discussing previously of 1950. I don't think there is any inconsistency between what the witness has testified to and what this par-

[fol. 5509] ticular portion of the deposition refers to.

Mr. Rosen: I will read, your Honor, where it says:

"On any one of your transactions where Mr. Rosenkranz"—

The Court: Overruled.

Q. As a matter of fact didn't you even testify that you gave Mr. Rosenkranz the $5000 which he purportedly gave to Mr. Malakoff?

A. Which 5000?

Q. The $5000 which was part of the transaction involving eight thousand some-odd dollars.

A. You mean the $7500.

Q. 7500.

A. The check of 7500.

Q. Yes, Mr. Katzenell.

A. I took the check from Mr. Rosenkranz because—

Q. I didn't ask you that. I asked you didn't you testify that you gave Mr. Rosenkranz the $5,000?

A. No, I gave him—I produced one check that I gave, $2,875, towards this loan.

Q. Page 276, and you notice we are examining on Mr. Rosenkranz, Mr. Katzenell?

[fol. 5510] A. Yes.

Q. Is that correct? I say, were we examining on Mr. Rosenkranz?

A. It speaks about those checks of $3600.

Q. That is right. Is that right? Were you asked this question and did you give this answer:

"You didn't give him the $500?

"A. As far as I can recall, yes, I think, I believe that I gave them my money."

A. Yes, my money. But how much? $2,875.

Q. "You didn't give him the $5000"—was this the question? Look at it.

A. Yes, I see it.

Q. And what was your answer?

A. I think I gave him some money.

* * * * * * *

[fol. 5563] "Q. Do you recall testifying and handing over all the checks to Mr. Menin in response to his question, answering 'These are the checks that I made out to Malakoff disregarding for whatever they were because I had with him an account, and whatever checks he asked me I gave him'?

"A. That's right."

* * * * * * *

[fol. 5569] "A. On May 10th, Mr. Malakoff invited me to take part in a deal of Nazareth Farmers Market.

[fol. 5570] "Mr. Robbins: When?

"The Witness: May.

"Q. What year?

"A. May, 1951.

"Q. Yes, Mr. Katzenell, what did you do?

"A. He told me that he bought a quarter interest from his nephew in Philadelphia and I gave him a check for $2,500.

"Q. Representing what? What was the conversation?

"A. For representing a quarter of his quarter.

"Mr. Rosen: The witness admits check for $2,500 dated May 10, 1951, to the order of John Malakoff. I ask that it be marked.

"(Check dated May 10, 1951 in the sum of $2,500 to the order of John Malakoff was marked Debtor's Exhibit 30 for identification.)"

Now were you asked those questions and did you give those answers?

A. Yes.

Q. So that when you testified for the Court on the trial in this proceeding that you didn't consummate any transaction and didn't purchase anything and you went out 10 or [fol. 5571] 15 times to the Market, and the first time you made an investment or purchase or got any interest in Nazareth was on September 4, 1951—was that true or was your testimony on pretrial on September 2nd, 1958 true?

A. Both are true for the following reason—

• • • • • • •

[fol. 5574] "Q. Do you know that Mr. Malakoff did sign any kind of receipts he was requested to?

"A. Maybe so."

• • • • • • •

[fol. 5675] Q. As one of the items entered for which you claim a balance due in 1950, do you have an item of $937.50 which you purportedly claim to have given to John Malakoff on April 5, 1950?

A. Yes.

Q. Now, that doesn't that $937.50 apply to the Jackie Gordon deal?

A. Yes.

Q. And then you received $19,000-some-odd on the Jackie Gordon deal, correct?

A. Yes.

• • • • • • •

[fol. 5676] Q. Now, when the $937.50 was put into the Jackie Gordon deal and then you received back the capital on the Jackie Gordon deal, that included the $937.50 and you received it back?

A. Yes.

• • • • • • • •

[fol. 5690] Cross examination.

By the Court:

Now in the light of your testimony on direct I am completely confused. Did it or didn't it go to the Jackie Gordon deal?

A. No. He put, your Honor, Mr. Rosen first of all now, in the last five minutes, he told me that I have made a statement that there was no Milton Kellem deal. I remember that I got a hundred dollars profit and I got the check.

Q. I am not interested in what you said on pretrial. It is quite clear to me that on pretrial you did state that there was no Kellem deal. But what concerns me is not that. It is manifest to me that a lot of statements were made at pretrial that contradict the statements that you made before me. Ultimately it will be my job to determine when, if ever, you were telling the truth.

But I am not concerned with the statements on pretrial. I am concerned with the conflict between your statements here in this courtroom before me as to this Kellem deal.

Now according to your direct testimony, you advanced eight, in other words, you advanced enough to pay the whole deal, with the understanding that when he sold the other [fol. 5691] three quarters you would get back three quarters

of your eight, and you testified that you got it back, and you produced a check to show that you got the 6000.

A. Yes.

Q. Then you say later on he sold the deal and you got your 2000 back and only $100 because he said he had to give the deal away.

A. Yes.

• • • • • • •

[fol. 5694] Cross examination.

By Mr. Rosen:

Q. Thank you. Now the June 29, 1950 $2500 item that you have marked "Margolis"?

A. That is, this went in the Jackie Gordon deal.

[fol. 5695] Q. That is right.

A. I am not claiming this money, Mr. Rosen—

Q. No, please.

The Court: Quiet. Answer the question only.

Q. So that this $2500 which you also have in the margin and which also on your records shows as unpaid, that went into the Jackie Gordon deal and you received back under the Jackie Gordon deal this capital; correct?

A. Yes.

• • • • • • •

[fol. 5698] Q. Now I show you item December 14 in your ledger—I am speaking constantly of Claimant's 7 in this trial—S. Rosenkrantz $2825, and your ledger shows that item unpaid and you have carried it over in red pencil as showing unpaid with an item $2850. Now, Mr. Katzenell, I believe you testified at this trial you received back this money, didn't you?

A. Yes.

Q. Including interest?

A. Interest, yes, profit; part of the profit or interest, you call it the way you want.

• • • • • • •

[fol. 5720] Q. Well, you paid that on Ocean Parkway and you took title to Ocean Parkway?

A. Yes.

[fol. 5721] Q. And then you handled it and sold it yourself?

A. Yes.

Q. And the $5000 was not owed by John Malakoff because you had used it as part of the purchase price on Ocean Parkway, isn't that so?

A. Yes, but I didn't want to buy this Ocean Parkway. I never went to look at it. I didn't want to buy this property. I had only been told to go and take title to it, and Mr. Malakoff, he was supposed to sell it and get my money back, and I only got $12,000 back.

• • • • • • •

[fol. 5727] Q. Here are two entries, one June 6, 1951 for $500. You have it entered under June 6, 1951, 290 East 3rd Street, $500, correct?

A. Yes.

Q. In your ledger under the year 1951?

A. Yes.

• • • • • • •

[fol. 5729] Q. Mr. Katzenell, I again ask you to look and tell me whether these two $500 items are not included in the total of $44,407.66?

A. Yes.

The Court: Yes, they are not included or yes, they are included?

The Witness: They are included.

• • • • • • •

[fol. 5731] Q. I again ask you, did you receive on the Jackie Gordon deal on April 3, 1951, $20,062?

A. Yes.

Q. So when you said No, that wasn't true?

A. No, it was true, because you formed the question, did you make in 1951 an entry.

Q. Mr. Katzenell, the question was just read to you and I didn't—

[fol. 5732] The Court: Come now. Will you stop quibbling? You have gotten him to admit that he received it on April 3, 1951. What more do you want?

Q. On your ledger—
A. Yes.
Q. —Claimant's 7—
A. Yes.
Q. —is there an entry to that effect?
A. Yes.

• • • • • • •

[fol. 5769] The Court: Sustained.

Q. Which of these stories are true? The one—
A. They are, both stories are correct.
Q. The one on the pretrial as to what transpired in May of 1951 or the testimony that you gave the Court as to what transpired and the conversation in May 1951?
[fol. 5770] A. It is true what—

The Court: I think you got a third. Which is true? His testimony on the deposition, his testimony on direct, or his testimony on cross? Because now he says he bought a quarter of a quarter of a contract as against 50 shares.

Q. Which of these three stories are true?
A. Mr. Rosen, please, I explained to you on the pretrial that I have given a check for $2500 for a venture in Nazareth. Other people have also given that money. It has been sold in the meantime. It came only later on, four or five months later, that Mr. Malakoff bought this Market, and there was a real investment which I made. That is—first I bought a contract—

The Court: I will construe your answer to mean that the third story is now the true story.
The Witness: Yes, your Honor, but all the three stories, they fit all together.
The Court: They may fit to you, Mr. Katzenell, but they don't fit to me, without a shoehorn.

• • • • • • •

[fol. 5814] The Court: Which gave rise to your getting possession of Claimant's 110, 111, 112, and 113.

A. My attorney at that time, Mr. Gotthelf, spoke to Mr. Malakoff, to have agreed that Mr. Malakoff will give me ten

notes as security for my stock which he did not have in his possession at that time, with the understanding that each note which he pays in the meantime until such date until he will get the stock will constitute a repurchase of five shares.

• • • • • • •

[fol. 5817] Q. Did you also testify as I just read that Mr. Malakoff paid three notes, that Mr. Malakoff paid three notes? When you testified here on this pre-trial. You testified that he paid three notes?

A. Yes.

• • • • • • •

[fol. 6041] Recross examination.

By the Court:

The Court: Did you receive $1750 from someone named Wachtel?

The Witness: Yes.

[fol. 6042] The Court: And was that for one-half of your one-half interest in the Blossom & Saul deal?

The Witness: I think so.

• • • • • • •

[fol. 6165] Direct examination of Jerome Fried.

By Mr. Rosen:

Q. Mr. Fried, because you haven't a lawyer I am submitting a prima facie case on your behalf in the same manner as I have done heretofore; but I am not representing you. You understand that?

A. I know.

Q. And if you have any objection or if you feel anything is improper that I ask you, even on your prima facie, you may voice your objection. I am not representing you.

• • • • • • •

[fol. 6166] Q. As you have claimed previously, you acted on behalf of your father Aaron Fried in acquiring on his

behalf three shares of the capital stock of Nazareth Fair Grounds & Farmers Market, Inc., is that right?

A. That is right.

Q. I show you photostat of a check which you furnished to my office dated December 7, 1951 and ask you whether you recognize your father's signature on that check?

A. Yes, I do.

Q. Did you receive that check from your father?

A. Did I receive it?

[fol. 6167] Q. This check originally from your father.

A. He gave it to me to give to John Malakoff.

Q. Did you then deliver it to John Malakoff?

A. Yes.

• • • • • • •

[fol. 6170] Q. I ask you to look on the reverse side of this check, which is dated December 7, 1951, and see if you can refresh your recollection from any notation that appears on that check?

A. That is why I answered the way I did. On the back side it says 1/200 share of Nazareth Fair Grounds & Farmers Market, Pennsylvania.

• • • • • • •

[fol. 6178] Q. Mr. Fried, I show you a check dated October 20, 1952 to John Malakoff, agent, for $2000 and ask you whether your father's signature appears thereon?

A. Yes, sir.

Mr. Rosen: Excuse me.

If your Honor please, may I withdraw that question and answer. We have a check here of January 1952, I would like to take it in sequence.

The Court: All right.

Mr. Rosen: Thank you, your Honor.

Q. I show you a check dated January 7, 1952 to John Malakoff for a thousand dollars which purports to have the signature of Aaron Fried—this is a photostatic check. Do you recognize the signature of Aaron Fried?

A. Yes, sir.

Q. Do you recall the circumstances, conversation time [fol. 6179] and place, who was present, when this particular check was transacted?

A. No, sir.

Q. Now the check on its face shows a date of January 7, 1952; correct?

A. Yes.

Q. I refer you and ask you if you can refresh your recollection to the notation which appears on the reverse side of the check as to what transpired.

A. It says for 2/100 shares of Nazareth Farmers Market and endorsed John Malakoff, John Malakoff, Agent.

• • • • • • •

[fol. 6185] Q. I show you a check dated October 20, 1952 to John Malakoff, Agent, for the sum of $2000 which purportedly bears Aaron Fried's signature and ask you whether you recognize that signature?

A. Yes, I do.

Q. Is that your father's signature?

A. Yes, it is.

• • • • • • •

[fol. 6186] Q. I ask you to look at the check, Mr. Fried, and the check is dated October 20, 1952, is that correct?

A. That is correct.

Q. And on the reverse side of the check I bring to your attention that there is the following notation: a thousand [fol. 6187] loan, a thousand one, 200 shares Nazareth.

Does that refresh your recollection as to what conversation took place at about the time or even if it happened prior to the issuance of this check of October 20, 1952?

A. That doesn't recall any recollection of any conversation.

Q. Was the notation a thousand loan, one thousand one, 200 shares Nazareth on this check prior to the check being deposited or for clearing in the account or clearing the account?

A. That is a little—I don't understand the question.

Q. Who put the notation a thousand loan and a thousand one, 200 shares Nazareth?

A. I did.

Q. Is that your handwriting?

A. Yes, sir.

Q. When did you place that notation on this check?

A. At the time that the check was made out to John Malakoff.

Q. In other words, would you say that notation was placed there by you on or about October 20, 1952?

[fol. 6188] A. I would say so.

• • • • • • • •

[fol. 6189] Q. I show you a check dated January 2nd, 1952 for $16.67 to the order of Aaron Fried, and then I show you checks respectively dated February 1, 1952, March 1, 1952, April 1, 1952, May 1, 1952, June 2nd, 1952, July 1, [fol. 6190] 1952, August 1, 1952, September 1, 1952, October 1, 1952, November 1, 1952, all in the sum of $33.34, checks Decembe[illegible] 1, 1952 in the sum of $50, January 2nd, 1953 in the sum o[illegible] $50, April 1, 1953 in the sum of $50, May 1, 1953 in the sum of $83.34, and ask you whether these checks were received by your father to your knowledge or by you on his behalf, and in any event whether his endorsement appears on the back of these checks.

A. His endorsement appears on all of these checks.

Q. Are all of these checks signed respectively John Malakoff, Agent or John Malakoff, Special and John Malakoff individually as appears on the specific checks, respectively?

A. It seems that all of these checks are signed by John Malakoff or John Malakoff, Special and one, agent; all three titles.

Q. Do you know what these checks represent?

A. They appear to represent his return on his investment with the Nazareth Fair Grounds.

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[fol. 6192] Q. And for giving a check of January 7, 1951 for $1000, the checks respectively of February 1, 1952, March 1, 1952, April 1, 1952, May 1, 1952, June 2nd, 1952, July 1, 1952, August 1, 1952, September 1, 1952, October 1, 1952 and November 1, 1952 in the sum of $33.34 represented a return of 20 per cent on $2000 that had been given, the total on January 7, 1952, inclusive of the one of December 7, 1951 of $33.34?

A. It seems correct again.

Q. That is a 20 per cent annual payment, monthly instalment?

A. Yes.

Q. And that for giving on October 20, 1952 an additional $1000 as claimed by you on the Nazareth investment, the [fol. 6193] checks of December 1, 1952, January 2nd, 1953, were payments of 20 per cent on an annual basis on the $3000 investment?

A. Correct.

Mr. Seligson: How much was that?

Mr. Rosen: $50.

Q. Now, I note that the checks of February and March of 1953 are missing from the debtor's file. Do you know whether there was any receipt of the payments of any $50 in February and March of 1953 that were made to your father Aaron Fried?

A. As I recall there were payments made in those months.

Q. Do you know from what source those payments were made?

A. To the best of my recollection they were drawn on an account at the Second National Bank in Nazareth.

Q. Were they corporate checks of Nazareth Fair Grounds & Farmers Market?

A. I can't be sure of that.

Mr. Rosen: Professor, have you a record of the payments previously referred to?

Mr. Seligson: February 2, 1953, $50 for Aaron Fried and [fol. 6194] March 2nd, 1953, Aaron Fried $50.

The Court: So that the record may be clear, what did you just read from?

Mr. Seligson: The report of Siegelberg & Company, accountants and auditors as of June 30, 1953 for Nazareth Fair Grounds & Farmers Market, Inc.

Mr. Rosen: My recollection may be wrong. I think that is in evidence.

Mr. Seligson: A copy of which report has been marked.

The Court: Yes. I just wanted the record to show what you were reading from.

Mr. Rosen: Yes, sir.

By Mr. Rosen:

Q. Now I show you in addition a check of April 1, 1953 for $50 and ask you whether to your knowledge that is still a return of 20 per cent annually on the $3000 which by this time Mr. Malakoff had received?

A. Yes.

Q. Now, among this particular batch of checks, Mr. Fried, we have a check here for $83.34 to Aaron Fried. Do you know what that check represents?

A. Offhand I don't know, Mr. Rosen.

[fol. 6195] Q. To your knowledge does that check represent any payment of interest on the money given to John Malakoff?

A. It could be, only because my dad only had that one kind of situation with John Malakoff.

Q. That 20 per cent return on $3000 represents only the return on $50 monthly payment, isn't that so?

A. Yes, but if I recall, I think there was a $1000 loan as well and I thought that—no, that wouldn't work out either. Unless he had more money loaned to him at the time that I can recall.

Q. Would this in any way refresh your recollection? $33.34 is equivalent to a 20 per cent return on $2000?

A. Yes.

Q. Isn't that correct?

A. Yes.

Q. Your father according to your story was only entitled to 20 per cent on $3000 claimed investment on Nazareth, isn't that correct?

A. Correct.

Q. Which would be equivalent to $50 monthly instalment payments?

[fol. 6196] A. Right.

Q. The amount of this check is $83.34 which would show an additional 20 per cent payment on $2000?

A. Yes.

Q. Received in the month of May?

A. Yes.

Q. And in April he had only received $50?

A. That is right.

Q. Now, was he receiving 20 per cent interest on loans that he made to John Malakoff?

A. No. At some time it worked that way, but there was no specific amount on any loan.

• • • • • • •

[fol. 6202] Cross examination.

By Mr. Rosen:

Q. At the time that you testified previously in the Katzenell claim you said you went up and signed as you claim blank certificates, is that so?

A. That is so.

[fol. 6203] Q. And that was when?

A. Some time in January, 1953.

• • • • • • •

[fol. 6221] BARRY CLARK, resumed.

Direct examination.

By the Court:

Q. Now am I to understand that your testimony is that you gave Mr. Malakoff, in addition to Claimant's 2 and Claimant's 3 in the Clark claim, a thousand dollars in cash?

A. Yes, sir.

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[fol. 6671] JEROME FRIED, having been previously duly sworn, resumed the stand and testified further as follows:

• • • • • • •

[fol. 6672] Direct examination (continued).

By Mr. Rosen:

Q. Mr. Fried, will you state the time, please, who was present and the conversation that led up to your purchase of two shares—is it two?

A. Of three.

Q. —of three shares of Nazareth stock?

A. Time and place is quite vague, except as it is related to other things.

Q. Will you kindly state them in sequence, if you can?

A. I will try, Mr. Rosen.

Some time in 1950 I had an interest in a Warren Street piece of property, located at 96 Warren Street.

• • • • • • •

[fol. 6675] Q. Did you pay this thousand dollars that you claim you paid by check or cash?

A. The check could have been paid to Malakoff or for Mr. Forman—I don't recall that. It was paid by check.

• • • • • • •

[fol. 6677] Q. When was it sold, to your knowledge, by you?

A. Some time in the winter of 1951.

• • • • • • •

[fol. 6678] Q. Do you know then what profit or what profit you claim was made on the sales price as between your original purchase price?

A. The total amount that I was to get at the time of resale was $2100 net. I think that was the figure. Between 2000 and 2100 dollars net. That is, after my thousand dollars came off the—

• • • • • • •

[fol. 6679] Q. What happened with your principal investment of the thousand dollars?

A. That I took. I got that back.

Q. So you got paid back a thousand dollars from Mr. Malakoff himself, I imagine, rather than taking it out of the check which you gave to Mr. Malakoff?

A. It didn't come out of the check I gave Mr. Malakoff.

Q. What I am saying is, Mr. Malakoff gave you his check for a thousand dollars.

A. Yes.

Q. So you got back your principal. And then the profit you claim of $2100 you left with Mr. Malakoff for him to use until such time as you picked out some investment that his office had?

A. I didn't say to use it. I didn't—

[fol. 6680] Q. What was Mr. Malakoff to do with the $2100? Was he to open a trust account?

A. He held on to it, that is all I know as far as—

Q. In other words, you gave it to him?

A. Yes, I gave it to him to hold until I found something that I wanted.

Q. You knew Mr. Malakoff, when you gave him money in that manner, utilized it as he saw fit?

A. I know now, Mr. Rosen; I didn't know then.

Q. Well, you didn't tell him to open up a trustee's account or anything, did you?

A. No.

Q. How long after the transaction involving your giving Mr. Malakoff this $2100 under the conditions that you claim did you have any further conversations relative to this $2100 with Mr. Malakoff?

A. Not until I decided I wanted a piece of Nazareth Fair Grounds.

Q. How long after was that? How many months?

A. Oh, not very long, Mr. Rosen.

Q. About how long?

[fol. 6681] A. A few months.

Q. Where was that conversation, and who was present? I might show you a purported, what has been purportedly called in this court a dividend check and ask you to look at your first dividend check, if that can refresh your recollection as to when you had the conversation with Mr. Malakoff, if at all, regarding any acquisition of Nazareth stock.

A. Well, based on this, I can only say that I had the conversation with him some time in August or September, '51.

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[fol. 6682] Q. Well, did Mr. Malakoff tell you that he had some type of interest or investment or acquisition in Nazareth, Pennsylvania, some property?

A. The things that sort of stick to one's mind, the things, like he would say to me, "I got something in Nazareth that is going to be a baby of mine, and this is something I am going to retire on"—and these things I can remember. But the general conversation is hard to remember. I would

imagine the only reason I remember things like that is because I was pretty much interested, being with Mr. Malakoff for only a short time and seeing the way he operated at that time. He spoke like words of wisdom, pearls of [fol. 6683] wisdom I remember about real estate.

Q. When you saw how he operated, Mr. Fried, in these general operations, from your observation and what you heard, was his method of operating one where he got various people to give him money for the purpose of their investing in real estate that he found?

A. It certainly seemed that way to me.

Q. From your observation and your knowledge, Mr. Malakoff was not a man of means, he had no real money?

A. Well, at that time I thought he had a great deal of money.

Q. What conversation did you have with him, either in the car or in his office, and who was present when the conversation took place regarding your acquisition of any interest in Nazareth?

A. I don't know that anyone was present, Mr. Rosen.

Q. What was the conversation, and try to be as specific as you can?

A. I merely told Mr. Malakoff to apply my 2100 or 2000 dollars towards the stock in Nazareth, towards the interest [fol. 6684] in Nazareth.

I am confusing things a little bit because I don't believe I knew there was a question of stock at that time; I am not sure.

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[fol. 6702] Q. When did you receive this stock certificate, Exhibit 3, and under what circumstances, by mail, in person, and from whom?

A. If I recall, I believe I picked it up at John Malakoff's office some time in the winter, when I got into New York occasionally after—while I was at Nazareth.

Q. Was that in 1953?

A. Yes.

• • • • • • •

[fol. 7074] Cross examination of
Arnold A. Weinstein.

By Mr. Seligson:

Q. Was the company able to pay its bills as they became due on July 30?

A. I remember, Professor Seligson, that after I became the president of this corporation and was going down from [fol. 7075] Nazareth regularly, I recall that there were on the books obligations of many thousands of dollars that had been past due, and I recall instituting a program which would be designed to reduce those obligations.

I might say that we never succeeded in reducing them completely.

Q. But on July 30 did Nazareth have the money necessary to pay its bills as they matured?

A. No.

Q. Did it have the money necessary to pay those bills when they matured on July 13 when Mr. Rosen was retained?

A. I don't know. I don't remember, really.

Q. Well, was there a change in the condition of the company between July 13 and July 30?

A. The only change that I can tell you of is the fact that I decided that we ought to try to go ahead and pay bills.

Q. Mr. Weinstein, you are not answering my question.

A. I don't quite follow you.

Q. Did Nazareth have the money on July 13 to pay all of its bills which were then due and payable?

[fol. 7076] A. No.

Q. And that is the day that you consulted with Mr. Rosen, is it not?

A. Yes.

Q. And that is the day he was retained to represent Nazareth in connection with the two judgments that had been entered and in connection with the stock dispute?

A. That is right.

Q. Now, what was the conversation or the discussion at the meeting on July 30 about the filing of a Chapter XI petition?

A. There was, as I recall it, this statement which appeared in the minutes drawn by Mr. Rosen that this was designed to protect the corporation in the event that somebody tried to jump the gun, because he didn't know what obligations were outstanding, and, as a matter of fact, none of us knew what outstanding obligations there were in this corporation.

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[fol. 7644] Cross examination of
Jerome Fried (resumed).

By Mr. Margolis:

Q. Mr. Fried, from the gross receipts debtor gets 15 per cent, isn't that right?

A. Not all the time.

Q. It gets less sometimes?

A. Yes, they do.

Q. It goes down as low as 12?

A. And sometimes less.

Q. And the rest goes to the operator of the races, meaning Nazareth Enterprises?

A. The rest—no.

Q. I mean the gross, the rest of the gross?

A. You are taking part of the gross out for the Market. A great portion of the gross goes to the boys that run the races as a purse.

Q. Yes. That is an operating expense.

A. Yes, because—

Q. In other words, the debtor gets 15 per cent of the [fol. 7645] gross?

A. They can't lose; that is right.

Q. Mr. Fried, will you please answer the question? We are trying to determine the debtor's take.

Mr. Margolis: Will you read the question?

(Question read.)

Q. Now isn't it a fact that debtor gets 15 per cent of the gross receipts?

A. Not always.

Q. Or 12 per cent?
A. Not always.
Q. They get less than 12?
A. Sometimes 10.
Q. And the rest of the gross naturally goes to the operator, which is Nazareth Enterprises, isn't that right?
A. Yes.

Cross examination.

By the Court:

Q. What determines the percentage that the—
A. Well, I have to explain that to your Honor. May I?
Q. Yes, I am asking you.
A. At the beginning, when—I had never seen a stock car [fol. 7646] race in my life until I came to Nazareth. I have to bring this out. I will try to be brief.
Q. You don't have to give me this whole story. I asked you a simple question.
What determines the percentage? Is it in the contract?
A. No. It depended—when I spoke to Mr. Weinstein about that it depended on the type of show we were putting on, inasmuch as certain types of shows, because of the higher cost, we would—the Market would still get more dollars and cents if I could possibly run this kind of show, even at a 10 per cent the debtor would get more rent in dollars and cents than if I couldn't run the show because of the 15 per cent rental. I couldn't possibly run that type of show. It wasn't just a single type of automobile race. And when I ran certain types of events the percentage became less because I just couldn't pay the other figure.

Cross examination.

By Mr. Margolis:

Q. Is it your testimony—

The Court: Just a minute. Let me see Margolis Exhibit C again.

(Mr. Margolis hands exhibit to the Court.)

[fol. 7647] Cross examination.

By the Court:

Q. Mr. Fried, will you please read the third paragraph of Margolis Exhibit 1 (handing to witness)?

A. Yes; I did.

Q. That paragraph provides that the debtor is to get 12 per cent of the gross receipts of the lessee except where the lessee sells food, in which case the debtor is supposed to get 15 per cent?

A. That is right. That is what the lease has been.

Q. Has that been adhered to?

A. It hasn't been always adhered to, no, sir.

Q. Has the debtor ever gotten any more than the lease provides?

A. In percentages, do you mean? No.

Q. Has the debtor ever gotten any less than the lease provides?

A. Yes, sir.

The Court: Are you listening, Mr. Rosen?

Mr. Rosen: Yes, your Honor. I hear everything.

Q. Was there ever a modification in writing of the terms of that lease?

A. No, sir. I might have sent the letter—

[fol. 7648] Q. I don't care what you might have done.

A. No, I don't recall anything in writing, your Honor.

Q. All right. Was there ever an oral, an attempted oral modification of the terms of that lease?

A. There was an oral modification of the lease.

Q. When did that take place?

A. Oh, some time in—after the new election, after the election of officers at the meeting in June, '53.

Q. Where did it take place?

A. Mainly at the Fair Grounds. It was discussed on several occasions.

Q. Who discussed it?

A. Mr. Weinstein and myself.

Q. What, in substance, was said by each of you?

A. Well, I had told Mr. Weinstein that, as the races were

going, it was absolutely useless for me to continue to run them because there was nothing in it, and I just didn't feel like—I already had a loss on it—I told him that there was a possibility, inasmuch as people were looking for more [fol. 7649] than just an ordinary stock car show, that if I could boost the purses and boost the type of show generally by giving double shows, two different types of shows the same day, I told Mr. Weinstein that I believed that we could draw enough people to make it worth while both for the Market and for myself, because if it didn't pay for me to continue to run them I just wasn't going to do them.

Well, I told Mr. Weinstein at that point that some of those double shows, the guarantee that I would have to pay for the shows ran around $2500, the guarantee payment for the exhibition, and that on the basis of how it was running it was absolutely impossible to do.

And Mr. Weinstein thought it was a good idea to give it a try to see whether or not the Market would get more dollars and cents out of the situation than we were getting before—when I say "we" I mean the debtor, your Honor—than the debtor was getting prior to my installation of this new type of show. And, as it turned out, it worked that way very well. My gross receipts went up quite heavily after that, and the rent became very good. Where I was only charging a dollar and a quarter admission we [fol. 7650] were able to get a dollar seventy-five to help defray the cost.

And then Mr. Weinstein agreed that on these particular days where a double show, as I call them, twin bills, you know, were held, then I would pay the 10 per cent. And the 10 per cent, your Honor, always was more than any 15 per cent that I was ever able to pay before that.

The Court: All right. Go ahead.

Cross examination.

By Mr. Margolis:

Q. Mr. Fried, did you ever take that up with directors, outside of discussing it with Mr. Weinstein alone?

A. I didn't.

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[fol. 8333] Cross examination.

By Mr. Seligson:

Q. Now, during the month of May 1953 while the races were being run who operated the food concessions?

A. I think at that time it was just Jim La Grotte, I [fol. 8334] don't think it was—I don't think he had the J & J yet.

Q. And did La Grotte pay to the debtor 15 per cent of the gross amounts received by him in connection with the food concession during the races?

A. I don't believe he did.

Q. And how much did the Nazareth Enterprises pay?

A. Well, as I recall, I think I was paying at that time, I think it was 12 or 15 per cent, I don't remember which.

Q. Well, according to the lease the amount to be paid was 12 per cent of the gross commissions except where the lessee operated the good concessions, in which case the lessee was to pay the lessor 15 per cent?

A. Yes.

Q. Now, then, in the month of May did you pay 12 per cent?

A. I remember certain times—I don't remember if this is one of those times, Professor, during that period where although—

Q. This is a few months you see before the filing of the reorganization petition.

[fol. 8335] A. Well, that is immaterial, and that does not matter to me as to what my thinking about that is, but at the time I had a conversation with La Grotte about how the rental would be paid, and inasmuch as I took the races originally with Sherman and this other party solely for the purpose of what kind of rental we could get for the market, but then when we opened the 1953 season these people refused to put any money into the races, these other people and—

Q. What other people?

A. Sherman and the other man, and there was a great deal of work that had to be done in that year, and so I felt that the picture would change. This was to be—sup-

posed to be done like in January, February or March before the races, but it never got done, you see, because they never came up with any money.

So I assumed the responsibility and set up the corporation and so on, and that was the end of the third party and Joe Sherman.

Q. In other words, you took over the races at the end of April 1953 when Nazareth Enterprises, Inc. was organized? [fol. 8336] A. No. I think I tried to open the races before the end of April regardless of whether the gross was set up or not. I think we got run out at the first four meets, if I recall correctly, and then—

Q. Just a moment. Did you pay Joseph Sherman anything for the assignment of the lease?

A. No, sir. He had nothing coming to him.

Q. Then you became the sole owner of Nazareth Enterprises, Inc.?

A. Yes, and at that point, and my recollection is helped by this particular Examiner's Exhibit AP, because I remember getting—checking the balance regardless of what the bank statement said, because there are always checks in transit and I always had checks that were written, and I am talking about debtor's checks.

Q. What happened that you remember?

A. I remember telling Jim La Grotte that although I would continue to have the races run, and I think it was 15 per cent, but I believe I told him to continue to pay his rent for his concessions on Sunday along with his Wednesday and Saturday business. In other words, I was not tak- [fol. 8337] ing the food concession as I should have done, but instead of that I was paying higher rentals for the races, and I told Jim not to pay me or the Nazareth Enterprises for the food concession at that time.

Q. Did you have any conversation with John Malakoff concerning the organization of Nazareth Enterprises, Inc.?

A. I don't remember if I did or not, Professor.

Q. Did you have any conversation with him concerning the assignment of the lease, the original of Margolis Exhibit C, from J. Sherman to Nazareth Enterprises, Inc.?

A. You mean the assignment of the lease?

Q. Yes.

A. I don't remember that.

Q. So that starting with March, 1953, you took over the races and you ran them for the balance of the year, is that right?

A. Yes, and the years after that, too.

Q. And since that time?

A. Yes.

Q. And you have run them since?

[fol. 8338] A. Yes.

Q. Now, you continued also as manager of the market, is that correct?

A. Yes.

Q. Did you draw a salary from Nazareth Enterprises, Inc.?

A. No, sir.

Q. What did you do with the income from the races?

A. Spent it on losses.

Q. You mean that you lost money in 1953 on the races?

A. I sure did.

Q. And does your accountant have a record of those losses?

A. Yes, he has.

Q. And did you continue to pay 15 per cent of the gross admissions to the debtor?

A. I don't remember how long I continued that. I mean the pressure got a little too much on me at that time.

Q. Did there come a time when you took over the food concessions at the races?

A. I never took them over per se.

[fol. 8339] Q. Well, did there come a time?

A. There came a time, yes, when I changed the method.

Q. Well, in what way did you change the method?

A. Well, I believe it was after—after I helped get the J & J Foods set up with regard to getting Jim a partner as my brother, and at that time I was given an offer by an outside food concessionaire from Philadelphia, and I don't recall the man's name any more, but he offered a price, a fixed price to let him in to run the food concessions on Sunday. He was not interested in the market concessions at all.

Well, it was a pretty good offer and I was very tempted to

take it because I needed money again in 1954, and getting an offer like this—

Q. What did you do? What did you do?

A. Well, If you don't mind, Professor, I would like to continue what I am telling you.

Q. Just tell us what you did, please, and not your reasons for it.

A. I finally worked out—all right, I finally worked the situation out.

Q. What did you do, please?

A. Well, I couldn't do anything, I have to say, then, [fol. 8340] except to say that I worked out my situation with the J & J Foods at that time.

Q. And when was this?

A. In 1954.

Q. And in what way did you work it out? What change was made?

A. The change that was made was that the rental of 15 per cent, you know I mean in going to the Nazareth Enterprises, Inc. instead of to the market, instead of to the debtor, and I would then pay the—well, I wasn't paying anything, but then I would pay the 15 per cent rent on the gross admission less the taxes to the market.

Q. Just a moment. The change was that you would pay to the market 15 per cent of the gross admissions?

A. After taxes.

Q. After taxes?

A. Yes.

Q. And that you would get the 15 per cent from La Grotte—

A. Right.

Q. And you say this started in—

A. Instead of my taking over the food concessions.

[fol. 8341] Q. You say this started in 1954?

A. Wait a minute. You asked me when did I take over the food concessions and not run the food concessions.

Q. You see, Mr. Fried, you are volunteering information that I have not asked you anything about.

A. Well, the point is I never took over the food concessions, to answer your question properly.

The Court: Well, then answer it properly and say never.

The Witness: Yes, I am sorry. I never took over the food concessions, but I thought that you would like to know—

Q. But you did finally—

A. —something else.

Q. But you did finally in 1954 make a new arrangement under which you agreed to pay the debtor 15 per cent of the gross admissions?

A. Yes.

Q. And you got 15 per cent from La Grotte on the food that was sold at the races?

A. Yes.

Q. And did you consult with anybody representing the debtor in regard to this change that was made?

[fol. 8342] A. I don't remember if I did or not.

Q. Prior to the time the change was made were you paying 15 per cent to the market, or to the debtor?

A. I believe it was on account—

Q. And in addition to that the debtor was getting 15 per cent from La Grotte?

A. Well, I think the records would show all that, Professor.

Q. Now, Mr. Fried—

The Court: This last arrangement in 1954 was after the petition had been filed in the Chapter X proceeding, wasn't it?

The Witness: Yes.

Q. And was that the arrangement under which you have continued operating down to the present time?

A. Not completely, no.

Q. In what way has it been changed?

A. It has been changed, and I don't remember when the change came about, but I had offered when these proceedings started in particular, and I was told by Mr. Rosen that my lease was rejected or was being rejected, and then—

Q. Please, Mr. Fried. All I want to know is was there [fol. 8343] a change, that is all?

A. Yes, there was a change.

Q. And when was the change?

A. I don't remember.

Q. So far you said that the other change took place in 1954?

A. Yes.

Q. Well, did this change take place within a few months after that?

A. I don't remember if the change took place in—

Q. Or a year or two?

A. I don't remember if the change took place in '53 or in '54 regarding the rental that I was to pay the market.

Q. Now, just a minute, Mr. Fried.

A. Yes, sir.

Q. Are you going back to the first change, the change that you made under which you paid 15 per cent of the gross admissions and you got 15 per cent from La Grotte? Are you saying that might have taken place in 1953 now?

A. No, you are asking me about the change in your questions, and if I may say so—

[fol. 8344] Q. Which change came first, Mr. Fried? Just answer that.

A. There was a change in the rental—

Q. Yes?

A. —regardless of the La Grotte percentage.

Q. Well, will you please answer which change came first?

A. I don't recall that, Professor.

Q. What was that change, then?

A. The change was that I had spoken to Mr. Weinstein—

Q. Please just tell us what the change was.

A. I paid a lesser rental on certain types of shows.

Q. What was it?

A. 10 per cent.

Q. On what?

A. On the gross admissions, less taxes.

Q. On all shows?

A. On certain types of shows.

Q. All right. What types of shows?

A. For example, if I would have a show that ran particularly the ordinary stock car shows, then that would be a reduction in the rent.

[fol. 8345] Q. And how ong did the ordinary stock car show run?

A. I don't understand the question.

Q. You just said that you had a show that ran on the time that the ordinary stock car show ran.

A. I didn't say anything about time. I said I would then discuss it.

Q. What would you discuss?

A. In other words, Professor, there are shows which were known as double shows, and it is an outdoor type of show where they use ramps and things like that and run over other cars, crash into them.

Q. Yes?

A. And that is another type of show.

Q. And on that type of show what did you pay?

A. 10 per cent. In other words, I would have two shows on the one day, whereas for general admission that was only about 50 per cent more than just the ordinary stock car show.

Now, I have to explain it so that you know what I am talking about.

Q. And so on some admissions you would pay 15 per cent and on others only 10 per cent?

A. Not on the same day. In other words, if I was running [fol. 8346] what we were advertising as the double show, then I would be paying 10 per cent.

Q. On what, on the admissions?

A. On the admissions for that day.

Q. For that double show?

A. Right, and that is when it was 10 per cent.

Q. And when was it 15 per cent?

A. When I would run just the ordinary stock car show.

Q. Now, with whom did you make the arrangements about this change?

A. Mr. Weinstein.

Q. But you don't remember when this change was made?

A. No, I don't.

Q. And this was a change that was made without regard to the arrangements had with La Grotte?

A. It had nothing to do with La Grotte.

Q. And had you continued—

A. It is just, Professor, that I wanted to give the races up; I didn't want to run them.

Q. Mr. Fried, there again I have not asked you for any reasons as to why this was done. I just asked you what the change was.

[fol. 8347] A. And I just told you.

Q. You told him—

A. Your Honor, may I say something, please?

The Court: No, just answer the question.

Q. Have you continued under both of these arrangements down to the present time?

A. Yes, I have.

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[fol. 8681] Direct examination of James La Grotte.

By the Court:

Q. Mr. Lagrotte, during the year 1952, when you had the food concession at the Market, where did you sell your food? I mean, did you have one location or a number of locations, and what were they like?

A. When I sold the food, your Honor?

Q. Yes.

A. We had three locations, your Honor, at that time, in '52.

Q. What did you sell?

A. Hot dogs, hamburgers, soda, and steak sandwiches. [fol. 8682] That was the only thing we were selling at that time.

Q. Were the races running at that time?

A. In '52? In June, 1952 I believe they were, your Honor, yes.

Q. Now who supplied the food that was sold to the people who came to the races?

A. At the end of the race season in 1952, I did, your Honor.

Q. Who supplied it before that?

A. H & M also.

Q. You say you took over H & M's lease, or did you get a new lease?

A. We got a new lease, your Honor, I got a new lease.

Q. You don't have a copy of that any more?

A. No. That burned, your Honor.

Q. You used to pay the Market 15 per cent of your gross receipts for rental, is that right?

A. That is right.

Q. Now did that arrangement include the food that you sold at the races?

A. At the races—no, your Honor. The races was paid to the promoter.

Q. How much?

[fol. 8683] A. 15 per cent.

Q. Who was the promoter then?

A. When I started it was Pat Zambrelli. I think that is the name. Oh, no. He was with the club. But the promoter, I don't know just what his name was.

Q. Was it Gordon?

A. That sounds familiar, your Honor.

Q. Whom did you actually make your payments to after the races of the 15 per cent for the food that you sold? Whom did you give the money to?

A. I believe, your Honor, that was Gordon. But we only had two races, two Sundays, that's all I had with him, the last two races that he was there.

Q. Now when did the races start in 1953?

A. In 1953, in April some time.

Q. Between April and September, 1953 did you supply food at the races?

A. That's right. I supplied food after that, all the way through.

Q. That was after you had your new lease, is that right?

A. Not yet. No, I didn't have no new lease yet.

Q. It was still the same lease under which you had gone in originally?

[fol. 8684] A. That is right.

Q. To whom did you pay the 15 per cent in 1953?

A. In 1953, to the Nazareth Farmers Market.

Q. You paid directly to the Market?

A. That is right.

Q. On what you sold at the races?

A. At the races.

Q. Was there a Fair in 1953?

A. Yes, I believe there was.

Q. Did you sell food at the Fair?

A. I had one stand, your Honor, that's all, at the Fair. The rest of them were closed.

Q. On that one stand, to whom did you pay?

A. Julius Fried, the rent. That is for one week.

Q. You paid that to Jerome Fried's brother?

A. Yes, your Honor.

Q. Now in 1954 were there races?

A. Yes, your Honor.

Q. Did you continue to supply the food, sell the food, during the races in 1954?

A. Yes, your Honor.

Q. To whom did you make payment of the percentage?

A. In 1954, in 1954, your Honor, I believe I started paying Jerry Fried then, Jerome Fried.

[fol. 8685] Q. It was in the beginning of 1954 that you went into the formation of J. & J. Foods with his brother, is that right?

A. That is right.

Q. Now J. & J. Foods sold food from stands and ran a bakery shop in the Market, is that right?

A. That is right.

Q. As to those receipts, to whom did you pay the 15 per cent?

A. To the Fair Grounds.

Q. When the races started, to whom did you pay the 15 per cent?

A. At the beginning of the season I paid Jerry Fried. No. At the end of the season. At the beginning of the season, 1954 I still paid the Fair Grounds.

Q. Do you know when you changed over from paying the Fair Grounds to paying Jerry Fried?

A. Not exactly the right date, your Honor.

Q. The races didn't start until April, did they?

A. In April some time.

Q. When did they end?

A. Some time in September, some time we run all the way up to October.

Q. I am speaking of 1954. Do you remember?

[fol. 8686] A. No, that I couldn't remember.

Q. Do you remember when Julius Fried got out of the J. & J.?

A. At the end of 1954, your Honor.

Q. Now, by the end you mean December or thereabouts?

A. In January, some time, '55.

Q. Of 1955. Now was it in July or June? Can't you remember when you changed the method of paying the 15 per cent on the races?

A. 1955 there was—

Q. No. 1954, I am still back on 1954. I understood you to testify that some time in 1954 you stopped paying the Farmers Market and you started to pay Nazareth Enterprises, is that right? Jerry Fried.

A. It might be a mistake on that. I started to pay Jerry Fried when his brother left me, the following year.

Q. January, 1955?

A. 1955.

Q. Before that you always paid the Market directly?

A. The Market, that is right.

[fol. 8687] Q. Was there a fair or a rodeo during 1954?

A. In 1954 it was a fair.

Q. Did you serve food at the fair?

A. That year, yes. Just the restaurant was open that year.

Q. To whom did you pay that 15 per cent?

A. Well, that 15 per cent went with my partner. I paid 15 per cent to Julius Fried and he paid me $100 to work the restaurant that week.

The Court: All right.

Direct examination.

By Mr. Rosen:

Q. You spoke of a change in 1954 or 1955. Will you tell us what brought about the change of not paying the

Market the 15 per cent and paying 15 per cent to Nazareth Enterprises?

A. In 1955—

Q. What brought the change about?

A. What brought the change?

Q. That is right.

A. Well, the first, I mean, I done that the way Jerry Fried told me to do it, because the races don't have nothing to do in my lease. In other words, when Jerry Fried told me to pay the Market the rent I paid the Market. When he said to pay him, I paid him. Now what arrangement [fol. 8688] he made on that, that I couldn't tell you.

Q. Well, did your lease call for—you say you had a lease in 1955.

A. Yes, for the Market.

Q. Nazareth Fair Grounds & Farmers Market, Inc.?

A. Yes.

Q. Have you that lease? If I recall, wasn't that lease submitted to the Court for approval? Was that the lease?

A. No. The new lease was submitted to the Court.

Q. Have you got the old lease?

A. No; that burned up.

Q. Under the terms of the old lease weren't you supposed to pay Nazareth Fair Grounds & Farmers Market, Inc. the gross commissions of 15 per cent on all foodstuff and beverages sold, whether it was on race day or whether it was on market day?

A. No. That didn't specify. The only lease I had was the lease from Nazareth Farmers Market for market nights. The way I understood, the races was run different altogether. I mean, Jerome Fried run the races. That don't have nothing to do with the Market. When he told me to [fol. 8689] pay the Market, I paid the Market.

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[fol. 8726] Cross examination.

By Mr. Seligson:

Q. But, in any event, you didn't pay 15 per cent of your [fol. 8727] gross receipts at the races to the Market?

A. No.

Q. You paid it to Gary Gordon?

A. That is right.

Q. Or somebody else?

A. Yes.

Q. And who told you to pay this 15 per cent to Gary Gordon?

A. What do you mean, who told me?

Q. Did somebody tell you to pay it to him?

A. No. Gary Gordon himself hire me for a concessionaire; he had the racetrack at that time.

Q. He had the racetrack?

A. Why, sure, if it's his name.

Q. In 1952?

A. Somewhere there. I am not sure. But it was the beginning of 1952, probably, or at the end. I am not sure exactly of the date of it, but that is when I started as a concessionaire at the racetrack, though, two weeks.

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[fol. 9010] Direct examination of
Richard S. Hull.

By Mr. Rosen:

Q. In other words, so that the next set of minutes that were entered, prepared and signed in the minute book was this meeting of June 4, 1953, correct?

A. That is right.

Q. And you had already resigned at that meeting as a director?

A. That is right.

Q. Mr. Hull, didn't you sign as a director?

A. I signed minutes subsequently, but I want—

Q. That is all I asked you.

A. Did I actually put my signature to minutes of meetings that occurred previously—

Q. I didn't ask you that.

A. What is the question?

Q. I asked you did you thereafter subsequent to your resignation as a director sign minutes that were drawn

thereafter and inserted in the minute book of the corporation?

A. Yes.

Q. That is all I asked you.

A. Applicable to a prior time.

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[fol. 9017] Q. I am sorry, Mr. Hull, let me try to review this, the sequence, June 4 was the meeting that you recall with Margolis?

A. Yes.

Q. About eight or ten days later was the meeting with Katzenell and his attorney and Kanter and so forth, is that right?

A. Right.

Q. So that we have reached about June 12 or 14th?

A. Right.

Q. And then you say there was approximately ten days to two weeks?

A. I would think so.

Q. So that we run into June 24th or the end of June?

A. Yes.

Q. So that we are now speaking of the meeting near the end of June of 1953. Where did that meeting take place?

A. If I recall, all but the big meeting took place at [fol. 9018] Malakoff's office.

Q. Who was present at this meeting?

A. The same people.

Q. In between this meeting of June 14th or approximately that date, which we have referred to as the second meeting?

A. Yes.

Q. The second meeting with Jerry Fried and yourself and Mr. Malakoff?

A. Yes.

Q. When were there any other minutes drawn in between the second and third meeting, which you have placed as between June 14th and 15th, and the end of the month?

A. Well, if you show me the minute book I will tell you that.

Q. (Hands book to witness.)

A. The minutes of July 2nd, 1952.

Q. When you say July 2nd, 1952, Mr. Hull, you mean where the dates are July 2nd, 1952, as well as July 2nd, 1953, isn't that so?

A. Yes. It seems to me there was another—it seems to me there was another meeting here.

Q. May I help you, Mr. Hull? You refer to the minutes [fol. 9019] of the meeting which are dated in this book October 22, 1952?

A. Yes.

Q. So you are now telling this Court that in between June 14th and 15th, 1953 and the end of June of 1953 and after you had resigned as a director on June 4, 1953 you drew the minutes of October 22, 1952 and the minutes dated July 2nd and 3rd, 1953?

A. 1952.

Q. The 2nd—1953 or 1952?

A. Yes.

Q. And had them signed by Jerome Fried as secretary and had yourself included as a party being present as a director?

A. That is right. A party being present as director at a time when I was director.

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[fol. 9020] Q. Mr. Hull, isn't it the fact that it was after an investigation started and after you received Claimant Saul Debtor's O that you had inserted and put into Examiner's I the minutes dated July 2, 1952 or July 2, 1953, respectively, and the minutes dated October 22, 1952?

The Witness: Could you read that back to me, please?

(Question read.)

A. Yes.

Q. So that it was after you had received a letter which stated that the proceeds for the sale of the stock had not been put into the treasury?

A. After I received some letter, I don't know whether it was that letter, after I received letters from Margolis. I received a batch of them, I remember.

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[fol. 9021] Q. Did you receive this letter, Debtor's O, which is dated May 25, 1953, before you drew the minutes that I asked you about and inserted them in the book?

A. I don't remember whether I received this letter. I received several letters, but I don't remember whether this was one.

Q. You notice the letter is dated May 25?

A. Yes, it is dated May 25. It is addressed to me, on the letterhead of Benjamin Margolis. I probably did receive it. I probably did receive it.

[fol. 9022] Q. Prior to your insertion of the minutes of July 2nd, 1952 or 1953 and prior to your insertion of--

A. Right, yes.

Q. —the minutes of October 22, 1952?

A. Yes.

Q. So that the time that you inserted those minutes and signed them you had been informed in writing that there were claims that the stock—

The Court: Mr. Rosen, the witness has testified that he inserted the minutes after he got the exhibit. I can divine no sane reason for you to repeat over and over and over again, by reading from the exhibit, what the man has already testified to. Please.

• • • • • • •

[fol. 9024] Q. Thank you. So that at the time that you drew the minutes when you were not a director, transferring stock of the corporation at $75 a share to Malakoff, you knew that there were stockholders that had paid a thousand dollars a share and were holding stock of this corporation at a thousand dollars a share?

A. Yes.

Q. Mr. Hull, while you were a director of Nazareth Fair Grounds & Farmers Market, Inc. and while you were the attorney for Mr. Malakoff personally, did you know that the only shares of stock issued to John Malakoff, according to the books and records of the corporation, were 20 shares of stock, which he had acquired purportedly from Zoloth & Sobel?

Mr. Robbins: Objection, your Honor.

The Court: Overruled.

A. I was under the impression that he owned all the shares of stock.

* * * * * * *

[fol. 9041] Cross examination.

By Mr. Weinstein:

Q. Getting back to Debtor's O in the Saul claim, you received that letter on or about May 25, 1953, didn't you, Mr. Hull?

A. I don't remember.

Q. All right. Do you recall in your testimony given before the Honorable John E. Joyce in the stock claims of Ida Mae Margolis and Sarah Kason, Volume 2, page 762, being asked these questions and having given these answers:

"Q. I show you a letter dated May 25, 1953, and ask you whether you received this letter from Mr. Margolis? May I say to you, Mr. Hull, it was taken from your file, or an original was taken that you gave me.

[fol. 9042] "A. It is probably so.

"Q. Read it, read it; don't tell me it is probably so.

"A. I said to you that I don't remember whether I received this in writing, but I do remember that I was notified of those things. Whether it was in writing—

"You asked me about something that happened four years ago.

"Q. You turned over a file to me with an exact copy of this letter.

"A. Does this come from that file? If it did, then I received it.

"The Referee: Pardon me, the witness will be given an opportunity to read the letter to enable him to answer it.

"A. If this came from that file, then I received it, because I gave you the whole file.

"The Referee: Is your recollection refreshed as to whether you received that letter?

"The Witness: Yes, it is addressed to me, and it has got my address on it. Yes, sir.

"Mr. Rosen: I offer it in evidence, your Honor.

[fol. 9043] "Mr. Margolis: No objection. We consent."

Do you recall having been asked those questions and having given those answers?

A. Vaguely, generally. I don't remember—if you ask me about these questions and answers without reading it to me, I wouldn't have remembered it.

Q. Do you remember it, now that I read it to you?

A. Generally, yes; not specifically.

Q. So isn't it a fact that you did receive this letter on or about May 25, 1953?

A. I still stand by what I said before, I don't remember. Whatever that says is a better recollection that I have now. That was three years ago and, in turn, was four years after the event.

Q. Now, then, Mr. Hull, I show you Debtor's P in the Saul claim for the purpose of aiding you in answering this question. Isn't it a fact that just a few days prior to the receipt of that letter you had prepared the minutes with respect to the issuance of some 180 shares of stock to John Malakoff on the date of July 2nd or July 3rd, 1953?

A. It would seem so, but I can't remember.

The Court: Would you read Mr. Weinstein's question [fol. 9044] back, please?

(Question read.)

The Court: Is that what you meant to say?

Mr. Weinstein: No, I did not.

The Court: Will you correct it?

Mr. Weinstein: I meant to say July 2, 1952 or July 1953.

The Court: That is different.

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[fol. 9052] Q. All right. At the time that you drew the minutes with respect to the issuance of 180 shares of stock to John Malakoff you knew of your own knowledge that the stock or the interest in this venture was being sold for an amount varying from $600 per interest or participation all the way up to a thousand dollars, didn't you?

A. Yes.

Q. And you knew, as early as August or September, when you made your own purchase, that the interest was going on sale for $600 a share at least; isn't that so?

A. 600 plus. It doesn't make any difference. I knew that there were varying prices or I had that impression.

Q. Now with this knowledge that you had, you as a director of this debtor drew minutes authorizing the issu-
[fol. 9053] ance of 180 shares of the stock of this debtor to John Malakoff for $75 a share, is that right?

A. I have already answered that at least twice. Yes.

Q. Now you also knew at the time that you drew those minutes that there was an over-subscription of stock, didn't you?

A. At the time I drew the minutes, yes.

Q. Now according to my notes, and correct me if I am wrong, Mr. Hull, you knew in late April or early May from a conversation that you had with John Malakoff that the stock was over-subscribed, didn't you?

A. Yes.

* * * * * * *

Q. I did not ask you that. I asked you whether, after [fol. 9054] you acquired that knowledge, you advised or told or disclosed to any of the stockholders the factum of this over-subscription?

A. No.

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[fol. 9353] Afternoon Session—2.15

JOSEPH SHERMAN, resumed.

The Court: I want to ask this witness a few questions.

Cross examination.

By the Court:

Q. Mr. Sherman, your claim on the thousand-dollar note is predicated upon alleged profits that were made when you and your co-adventurers were operating the races; is that correct?

A. Yes, sir.

Q. And that money, instead of being turned over to you, was used for the corporation and that is how you came to get the note.

A. Yes, sir.

Q. Now when did you and your co-adventurers, and by that I mean Mr. Fehr and Mr. Fried, when did you undertake to operate the races?

A. I believe around the 17th, between the 17th and the 21st of August.

Q. Of 1952?

A. 1952.

Q. Yes. Now what was the arrangement; how long were you going to operate them?

[fol. 9354] A. We were going to operate until November, until the weather, as long as the weather permitted, and then start again in the spring of the year.

Q. Well, there was a lease entered into at that time between the Fair Grounds and yourself, wasn't there?

A. Yes, sir.

Q. How long was that—you say that lease was to operate just until the fall?

A. No. That lease was to operate for the ensuing year.

Q. Ensuing year?

A. Yes.

Q. In other words, up through the racing season of 1953?

A. That is correct.

Q. I see. Now I show you Margolis Exhibit C in the J. Fried claim. Is this the lease that you entered into where you undertook to operate the races?

A. Yes, sir.

Q. All right. Now that lease was executed when?

A. August 18.

Q. Of 1952?

[fol. 9355] A. 1952.

Q. How long was it supposed to run by its terms?

A. The 30th day of November, '52.

Q. Now look at it very carefully.

A. Well, it looks like "62," your Honor, on this.

Q. Yes. Doesn't it look like somebody changed that from "52" to "62" in pen in ink?

A. Well, I couldn't say that, Judge, but evidently it would look like it, the way it looks here.

Q. But your recollection, regardless of that document, is that you never entered into a ten-year lease, is that correct?

A. No, sir.

Q. Is that your recollection?

A. That is my recollection.

Q. All right. Now, you subsequently assigned that lease to Nazareth Enterprises, Incorporated, didn't you?

A. Yes, sir.

Q. All right. Now, I show you this document marked Examiner's I in the J. Fried creditor's claim and ask you [fol. 9356] whether this is the document by which you assigned that lease to Mr. Fried?

A. Yes, sir.

Q. Now read that document carefully. What lease does it refer to that was assigned? A lease dated what?

A. This lease was given to them of the lease dated August 18th.

Q. Of what year?

A. Of 1953.

Q. Well, did you have any lease dated August 18th, 1953?

A. Well, it is my supposition that I did, Judge. I believe this particular lease runs to that particular date.

Q. In other words, what you are telling me is that the instrument which you last examined which purported to assign a lease dated August 18th, 1953, was intended to apply to a lease dated August 18th, 1952?

A. No. '52 to run to '53.

Q. Just a minute.

A. You see, this, it looks like 62, your Honor.

[fol. 9357] Q. Forget about the '62.

A. I thought it was '53 to run to that far.

Q. Look at the instrument, which is—I want to identify it for the record.

A. This one (indicating).

Q. Which is Examiner's I in the Jerry Fried creditor's claim.

A. Yes, sir.

Q. Doesn't that state that "You have sold and do hereby assign, transfer and set over unto Nazareth Enterprises, Inc. a certain lease dated the 18th day of August 1953"?

A. It says that there, yes, sir.

Q. All right. All I want to know is, did you have a lease dated August 18th, 1953?

A. I don't remember, sir.

Q. Well, did you have any lease other than Margolis C in the Fried creditor claim?

A. No, sir, I don't believe so.

Q. Now Margolis C in the Fried creditor claim is dated August 18, 1952, isn't it?

A. That is right.

Q. All right.

A. And I have thought it was—the purpose of this one [fol. 9358] I thought it run to the 18th of '53.

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[fol. 9425] Direct examination of Gilbert Sunshine, resumed.

By Mr. Rosen:

Q. Now where did you go after you reached Philadelphia?

A. We went to, I think it is called, Murray Realty, or [fol. 9426] Eddie Malakoff's office, and from there we were taken to the accountant's office, Waldbaum, Rockower & Company.

Q. Who did you go with?

A. In Philadelphia, with Mr. Malakoff and Mr. Fried and Miss Bernstein.

Q. And Mr. Hull?

A. And Mr. Hull.

Q. Was there any discussion in Eddie Malakoff's office when you were there about the debtor?

A. We were there just a very short time.

Q. Then you left from there to go to Rockower's office?

A. Yes, sir.

Q. Did you go by car, do you recall?

A. No, sir.

Q. In any event, you got to Rockower's office in Philadelphia. And who was present in Rockower's office in this early part of December 1952?

A. The same group. And I don't recall whether Mr. Rockower came out himself for a few minutes or not; but basically we conferred with a Mr. Thomas.

Q. When you say the same group, you mean Mr. Malakoff, Mr. Hull, Mr. Fried, Helen Bernstein?

[fol. 9427] A. Yes, sir.

Q. And an assistant?

A. And Mr. Thomas.

Q. And Mr. Thomas. What discussion was had there at that time?

A. They produced a book which—

Q. Can I kindly have the minute book and the stock certificate book and the ledger?

A. That black ledger book.

Mr. Rosen: I have it, your Honor.

Q. I show you in the Saul claim Examiner's B-U and ask you whether this book was handed over in Mr. Rockower's office?

A. Yes.

Q. Do you recall seeing Examiner's I in the Saul claim and being handed over which is the minute book of the corporation?

A. I saw a red book, but they were not given to me, they were given to Mr. Hull.

Q. And did you see Examiner's H or any stock certificate books, do you recall?

A. Certain stock books were given to him as well.

Q. Was there any discussion at the time that those books [fol. 9428] were delivered?

A. Yes. I asked for some information on the corporation and what was in there. And they—Mr. Thomas had his work papers, and from those work papers, where he had already completed the return for the year ending June 30, 1952, he had a balance sheet and a P and L statement. And Mrs. Bernstein copied them. And this is the copy that she brought back.

Q. Were they copied in your presence?

A. Yes.

Q. You saw her make this copy?

A. I don't know if I saw her physically write it. It was written that day. I don't know whether—

Q. Is this her handwriting, do you know?

A. I believe so. I don't know.

Mr. Rosen: I offer it in evidence.

The Witness: I don't know whether it is her handwriting or not.

Mr. Seligson: No objection.

(Debtor's Exhibit X in the Saul claim received in evidence.)

Q. What discussions were had, if you recall, at the [fol. 9429] particular time that these various books were turned over, by whom, and what was said to whom, if you recall?

A. One point I raised was, was the capital correct in the amount of 20 shares of stock and a value of $1500.

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[fol. 9430] Q. Did you have any discussion on the train, and with whom?

A. Again with Mr. Hull and Mrs. Bernstein, if she was there. It is my recollection that she was, but I am not sure.

Q. And what was your discussion?

A. Again about the capital of the corporation.

Q. What was said, if you recall the substance of what [fol. 9431] was said?

A. Basically we—it had been my impression that Mr. Malakoff was to purchase this business for a sum substantially in excess of $1500, and the problem was how could we properly reflect that on the books. And we got nowhere with it on the train.

• • • • • • •

[fol. 9432] Q. Did you have any further discussions with any of the parties in interest of the debtor corporation prior to December 12, 1952 which led to your forwarding this letter, Debtor's V?

A. Yes.

Q. With whom, and when, and where, if you recall?

A. With Mr. Malakoff in his office. I endeavored to ascertain from him what he paid for the corporation and the number of people who were going to participate in it.

[fol. 9433] Q. And what was said?

A. He told me that he had paid $115,000 for the corporation—for the stock.

Q. Did he say—

A. —and that he was going to divide it amongst a group of people.

And I asked him the number. And he wasn't specific. And I endeavored to pin him down, and I started counting. And the answer that I got was, when I got to five, it was more than five.

Q. Did Mr. Malakoff say to you that he was going to pay or that he had paid?

A. Presumably he said he had paid, because until he had paid for this corporation the books were never released to him.

Q. Did he tell you that there were other participants in the purchase?

A. Yes, sir.

Q. And did he tell you that the participants in this purchase were more than five?

A. Yes, sir.

Q. I notice that in Debtor's V you refer to a participation by more than five in this purchase by Mr. Malakoff on a pro rata basis. Does that refresh your recollection [fol. 9434] as to the conversation you had with John Malakoff?

A. It meant that these people were buying on an equal basis.

Q. With John Malakoff?

A. Yes. Their shares would all be equal, on an equal footing.

Mr. Seligson: May I have the answer read.

(Answer read.)

Q. Did you have any further discussion as to the books and records showing a $1500 capitalization and what was happening with the moneys of the people that were going in on a pro rata basis with John Malakoff?

Mr. Seligson: One moment. That question is a little bit difficult for me to get.

(Question read.)

Mr. Seligson: If he understands it, I have no objection.

The Witness: I think I do.

A. The discussion that I had with Mr. Malakoff was that if people were to put money into this corporation for stock

the moneys would have to appear in the corporate treasury and that there was no indication that any such moneys [fol. 9435] had been put in.

Mr. Seligson: Wait a minute.

Your Honor, I would like to know what he said to Mr. Malakoff and what Mr. Malakoff said to him.

Mr. Rosen: That is what is saying, Professor Seligson.

The Court: Read the answer.

(Answer read.)

The Court: Is that what you said?

The Witness: Yes, sir.

Q. What did Mr. Malakoff say?

A. He said that as soon as he had completed the final arrangements on who was to come into the corporation, that he would transfer the necessary moneys to the corporate treasury.

Mr. Seligson: Can you fix the time of this conversation?

Q. Yes.

A. Again some time in December or January, 1952, sir.

Mr. Seligson: January '53?

The Witness: '53, I am sorry.

Q. Now, did you have any further discussion in relation- [fol. 9436] ship to this item with anybody else?

A. Yes, sir. I discussed the—I showed the letter that came back from the American Institute of Accountants—

Q. When you say "the letter," you are referring to Debtor's W (showing)?

A. Yes, sir. I showed this to Mr. Malakoff and I explained the problem that was arising, and he told me to contact Mr. Hull and discuss the matter with him further, which I did.

Q. And this is still in, do you recall—

A. This would probably now be in January.

Q. You noticed you received this letter on, apparently it was dated December 18, 1952. Does that help you refresh your recollection?

A. Well, I doubt if anything much was done at the end of December. This came back just before the holidays, and I doubt if anything much was done in December.

Q. So that either somewhere near the end of December or the early part of January you went up to Mr. Hull's office?

A. No, sir.

Q. Where did you meet Mr. Hull?

[fol. 9437] A. I met Mr. Hull for lunch in a restaurant in the 34th Street—the Penn Station.

Q. What restaurant, do you recall?

Mr. Seligson: The Savarin?

The Witness: Very possibly, sir.

Q. Did you have a discussion there with Mr. Hull?

A. Yes, sir; I explained him the problem that was here—

Q. No. Will you kindly—again we would appreciate it if you would tell us what you said and what he said?

A. I explained to Mr. Hull that the corporation reflected 20 shares of stock and $1500 capital, that Mr. Malakoff planned to sell stock in addition beyond that, that no moneys were put into the corporate treasury reflecting anything like that, and that Mr. Malakoff said when he had worked out the arrangements for all the sale that he would deposit the moneys into the corporation.

Q. What did Mr. Hull say?

A. He would take the matter up with Mr. Malakoff and they would resolve it.

Q. What happened next in conjunction with this par-

[fol. 9438] ticular subject matter, if anything did happen?

A. Nothing happened, sir. It was never resolved.

Q. Did you take that matter up again, or do you recall discussing it or requesting that something be done on this matter subsequent, let us say, to January of 1953?

A. I took the matter up once more with Mr. Malakoff.

Q. When and where?

A. Again in his office. And this would have been in the middle of February, somewhere in February.

Q. What did Mr. Malakoff say at that time?

A. That he had not yet completed the final arrangements and that when he did he would see that the entire thing was rectified.

Q. Were you told at any time that Mr. Malakoff was going to put up anywhere from 75 to 115,000 dollars, whether those moneys were given to him by other investors, and that he was to sell the stock to himself at $75 a share and make the profit between the $75 and the thousand dollars a share or $600 a share?

[fol. 9439] A. No, sir.

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[fol. 9440] A. From this book it indicates that the Market must have originally been purchased on April 17, 1951.

Q. When you say "this book," will you please refer to the exhibit?

A. I am sorry. B-V—

Q. Examiner's B-U.

A. Examiner's B-U, I am sorry, Saul.

That the Market must have originally been purchased on April 17, 1951, by Morris Sobel in his own name for a sum of $40,000, plus first and second mortgages and several—and two loans. On that same date—

Q. How much loans and mortgages?

A. There was a first mortgage of $8500, second mortgage of $10,000, a loan due M. Levy for $5000 and a loan due M. R. Company of $2732.99. I think "M. R. Company" stands for Muray Realty.

On that same date the journal entry was made charging [fol. 9441] the Murray Realty loan account and setting up a J. Malakoff capital account. And the explanation in the book reads "To record investment made to M. R. Company."

On August 7, 1951—

Mr. Seligson: I am sorry.

The Witness: Would you care to look at this work sheet with me, Professor?

Mr. Seligson: No.

The Witness: That might be easier.

Mr. Seligson: I think I can get it much better by listening to you. But some of this is not clear to me. I can go over it later. You go ahead.

A. On August 7, 1951 the books were closed and two entries were made at that time, one charging Morris Sobel's

capital account for $38,500 and setting up a capital account for Milton Zoloth of $1500 and a loan account for Morris Sobel of $37,000.

Q. Stop right there for a moment.

A. Can I just read the explanation?

Q. Yes.

A. The explanation reads "To credit correct accounts."

[fol. 9442] Q. Now to your knowledge was there any actual money put in to create this loan account at the time the entry was made in the books?

A. No, sir.

Q. In other words, it was merely a book entry?

A. Yes, sir.

Q. And originally it was capital?

A. Yes, sir.

Q. Proceed.

A. There was also another entry made charging Jack Malakoff's capital account for $17,489 and transferring it to his loan account. Again the explanation, "To credit the correct accounts."

Q. From the records, from your knowledge as an accountant was that money actually put in as rent or was that a book entry?

A. It again appears to be a book entry.

* * * * * * *

[fol. 9447] Q. Will you give the Court your opinion of the various book entries and what they reflect, as far as your interpretation is concerned?

A. Briefly, it indicates that an individual purchased the business from somebody; the source is not indicated; and that he had one or more partners in this venture, and that when he reached a certain point they decided to incorporate this business, and I would think that going with the tax thinking that prevailed in that day, that they endeavored to show the largest sum for loans imaginable, to endeavor to minimize their tax liability if and when one would be due.

Q. So originally those loans were capital?

A. It appears so. Not all, but most of them.

Q. And it was merely a bookkeeping entry, no actual money was put in as loans in a material sense subsequent [fol. 9448] to the time of this so-called capital investment in the partnership?

A. If it was, I just don't see any indication of any substantial sum along those lines.

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[fol. 9450] Mr. Seligson: Is this the transcript of the loan account or the exchange account?

The Witness: The exchange account, sir.

Mr. Seligson: In other words, there were separate loan accounts?

The Witness: The exchange account is separate and distinct from the loan account I previously described.

Mr. Seligson: No objection.

(Marked Debtor's Exhibit Y in the Saul claim.)

Q. At various times it appears from Debtor's Y that [fol. 9451] John Malakoff overdrew on this loan exchange account. Did he ever request or direct you to credit him with any of the overdraws on the other loan account?

A. No, sir. This account was kept as a separate account. He kept a running balance of his own and checked with me each month.

Q. On this account was there a balance due the corporation from Mr. Malakoff?

A. Yes, sir.

Q. What is the balance due?

A. $3,898.25.

Q. Were you ever asked to credit that by Malakoff to the other loan account?

A. No, sir.

• • • • • • •

[fol. 9459] Q. To your knowledge, both from your checking various bank statements as well as the books and records of Nazareth Fair Grounds & Farmers Market, Inc., is there any evidence or any proof or did you come across any fact which shows that any of the moneys that Malakoff received for the sale of interests or stock in this venture of Nazareth Fair Grounds & Farmers Market, Inc. was

[fol. 9460] put into the corporate treasury or the corporate account?

A. No, sir.

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[fol. 9548] Cross examination.

By Mr. Seligson:

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A. Originally it was in the capital, and his capital account was decreased by the two items plus the loss that the partnership incurred for the period of its operation, leaving a net balance in the partnership capital account of $823.56, and then subsequently when the corporation was formed that $823.56—$750 of it was put into corporate capital and the balance was transferred to the individual loan account.

Q. You mean that in the partnership records there was a capital account for the partners?

A. Yes.

[fol. 9549] Q. And in that capital account the total amount that was contributed—

A. May I stop you, sir?

Q. Yes.

A. Initially there was this capital account for Milton Sobel as an individual.

Q. All right. Well, let us go back.

Cross examination.

By the Court:

Q. In what amount?

A. $40,000.

Q. Exactly. Now, the error, or the basic question that the Professor asked was what was wrong? Am I to understand that one of the things that was wrong was that there was no evidence to substantiate the transfer from Sobel to Zoloth?

A. Well, it was just arbitrarily transferred.

The Court: That is what you were driving at, Professor?

Mr. Seligson: Yes.

Q. Let us start off here: Who had that $40,000 capital account to his credit in the partnership?

A. In the individual's name was Milton Sobel of $40,000.

Q. All right. What happened to that $40,000?

[fol. 9550] Mr. Seligson: Your Honor, before we get to that I would like to find out how we get that $40,000.

The Court: All right.

Cross examination.

By Mr. Seligson:

Q. Now, you say that the business was purchased originally by Maurice Sobel?

A. It appears that way, sir.

Q. From the records it appears that way?

A. Yes.

Q. I am only talking from the records. You have no independent knowledge, do you?

A. No, sir.

Q. And that was on April 17, 1951?

A. It may have been purchased prior to that, but that is the date shown in this book.

Q. Now, how much was paid by Maurice Sobel for the building and business?

A. I can read the opening entry to you, sir: Building, $66,000; building settlement costs, $456.50; insurance, $45.78; taxes, $39.69. Those are the total debits.

Q. And that makes a total cost of land and buildings of how much? $66,541.97, is that correct?

A. You are faster than I am.

[fol. 9551] Q. No, not faster. You give me your report.

A. That is so. There was—

Q. Let us get that first. Is that right?

A. Yes, sir.

Q. Now, what was due against that?

A. Taxes of $45.48; mortgage interest of $263.50; first mortgage, $8500, second mortgage $10,000; loan, M. Levy, $5,000; loan M. R. Company, $2,000; $732.99; M. Sobel capital.

Q. That makes these liabilities a total of $26,541.97?

A. That would be right.

Q. And if you deduct that from the purchase price you get this balance of $40,000, which is set up as capital?

A. Yes.

Q. For Maurice Sobel, is that it?

A. Yes.

Q. Now, is there anything in these records that leads you to believe that $66,000 was not paid for the land and building?

A. No, sir. There is nothing here to indicate that it was, either.

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[fol. 9593] Q. Did John Malakoff tell you in this conversation that he intended to issue more stock?

A. Yes, sir.

Q. Did he tell you to whom?

A. No, sir.

Q. Did he tell you at what consideration?

A. No, sir.

Q. Did you ask him?

A. Yes, sir.

Q. What did you ask him? What did you say to him?

[fol. 9594] A. I asked him specifically, how much and to who, if he knew, and for what, and the amount of shares.

Q. What did he say?

A. I didn't get an answer, sir.

Q. Did John Malakoff tell you that he wanted the balance sheet of the corporation to reflect an investment of $115,000 by him?

A. He wasn't sure what he wanted it to reflect, sir. I stated to him that if stock were sold and this money was due to the corporation, that those moneys would have to be deposited in the corporation.

Q. Wait a minute. You stated to him that if stock were sold and the moneys were due to the corporation—

A. Right.

Q. —that the moneys would have to be deposited in the corporation?

A. In the corporate treasury.

Q. Did he tell you that he intended to sell stock, unissued stock?

A. Yes, sir.

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[fol. 9597] Q. Now after you got the reply, which has been marked Debtor's Exhibit W, I understand you spoke to Mr. Malakoff about it?

A. And Mr. Hull.

[fol. 9598] Q. Well, first Mr. Malakoff; isn't that what you said?

A. Yes.

Q. And then he referred you to Mr. Hull?

A. Yes.

Q. And after you spoke to Mr. Hull, did Mr. Hull give you any instructions?

A. No, sir.

Q. What did he say?

A. He would go back and discuss it with Mr. Malakoff and when they had ironed out that end of the situation as to whether the number and the amount and the shares that were to be issued, they would sit down with me once more and we would try to resolve the problem.

Q. When did Mr. Hull tell you that? Well, was it shortly after the letter came in?

A. I would say the beginning of 1953.

Q. January 1953?

A. January or February, sir.

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[fol. 9613] Cross examination.

By Mr. Rosen:

Q. Mr. Sunshine, let me ask you a question in this manner, if you please: Will you kindly look at Examiner's JJ and will you tell me whether after examining Examiner's JJ whether in the Sobel situation it appears that Mr. Sobel

was paid out from the moneys from the moneys received from John Malakoff on this $40,000 capital investment or loan?

A. It would appear so from this sheet.

Q. So that out of the total amount that you previously testified Malakoff paid on this particular deal, it appears that $40,000 of that amount went to Sobel?

A. Yes.

Q. In reduction of this $40,000 capital investment or loan?

A. This only shows $36,000.

Mr. Seligson: What is that?

The Witness: This only shows $36,000. Thirty-five and one thousand totaling 36,000.

Mr. Seligson: That exhibit shows that money going to Sobel?

The Witness: Yes, sir. 35,000 on one page and a thousand on the other.

Q. Now, there has been some testimony that the Sobel loan was carried over into the books of Nazareth Fair [fol. 9614] Grounds and Farmers Market, Inc. and was carried over as a loan. I am starting with the original $40,000. How much of that $40,000 was carried over as a loan into the books of the Nazareth Fair Grounds & Farmers Market, Inc.?

Mr. Seligson: Your Honor, unless there is some special purpose, this has been gone over on three separate occasions.

Mr. Rosen: There is a special purpose.

Mr. Seligson: Mr. Robbins and I have gone into that very, very carefully.

The Court: I will allow it.

A. Of the $40,000, $37,073.46 were transferred on the corporation's books to M. Sobel loan account, $73.46 to Milton Zoloth loan account and $1,500 to the capital account.

Q. Now, the $37,000 then was transferred over on the books to John Malakoff, right, of this original forty?

A. That plus the $73.46.

Q. So as far as the books and records of the debtor, they still reflected—

A. That original $40,000.

Q. That had been paid Sobel, $37,000-odd as payable to [fol. 9615] John Malakoff?

A. Yes, sir.

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[fol. 9616] Q. Now, can you refresh your recollection whether in this conversation with John Malakoff there was any statement made by John Malakoff that he was entitled to draw various sums of money for handling this transaction?

A. In the course of our original discussion he disclosed that he had contemplated getting—I don't know what you call it—a management fee, or what you would call it, for supervising the operation of the Market plus whatever expenses he had on it.

Q. Now, originally when you discussed the question of the sale of the stock of Nazareth Fair Grounds & Farmer Market, Inc., and I refer you to Debtor's V, next to the last paragraph thereof, regarding the acquisition by more than five others on a pro rata basis, didn't Malakoff tell you he wasn't in this thing merely to give everybody the same deal as himself, that he was looking to make money?

[fol. 9617] Mr. Seligson: Your Honor, I object.

The Court: Sustained.

Q. I ask you to look at Debtor's V, the last paragraph thereof, exclusive of the words "your comments," and tell me whether that refreshes your recollection as to what John Malakoff said he was to get out of this deal?

Mr. Seligson: I object to the question. There has been no testimony—

The Court: Sustained.

Q. In response to the Examiner's cross-examination you spoke about a conversation you had with John Malakoff, is that right?

A. Yes, sir.

Q. Do you recall whether you had any further conver-

sation with John Malakoff at that time regarding his contemplated sale to more than five stockholders on a pro rata basis? What else, if anything was said?

A. Merely what it says here, that he contemplated that he had already divided the acquisition among more than five people and that they were going to share on a pro rata basis.

Q. That is inclusive of himself?

A. Everyone was.

[fol. 9618] Q. Did you thereafter have any further conversation on a later date regarding that matter?

A. Only to find out if he had done anything with or about Nazareth, to which I never got a response.

Q. Did you discuss with him and did you request that he put into the corporate treasury the moneys for the stock that he sold?

A. I did.

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[fol. 9619] Q. Did you have a conversation with Malakoff in any form regarding, or as to what Malakoff was to get out of this situation?

A. Just what I said before.

Q. What was that?

A. That he was to get a fee, a management service charge or salary, or whatever it was going to be decided on, plus expenses that he incurred.

Q. And that is what he told you?

A. That is right.

Q. And do you recall when that was told you?

A. Probably around the beginning of 1953; maybe the end of 1952.

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[fol. 9767]

COLLOQUY BETWEEN COURT AND COUNSEL:

The Court: All right, Mr. Weinstein, will you stipulate on the record that you purchased stock of the debtor subsequent to the date upon which I ordered that you be paid compensation?

Mr. Weinstein: That is the fact.

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[fol. 9768] The Court: I know that. I am asking you a simple question. Will you stipulate that you acquired, by purchase, stock of the debtor corporation at a date subsequent to the date upon which I originally fixed your compensation.

Mr. Fried: Yes, sir.

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[fol. 9770] The Court: Mr. Fried, do you now stipulate that you are the sole stockholder of Nazareth Enterprises?

Mr. Fried: I said I was the controlling stockholder, your Honor.

The Court: How much of the stock do you own?

Mr. Fried: There are two shares issued of a hundred.

The Court: Well, how much of the issued outstanding stock do you own?

Mr. Fried: I only say it is my own because my wife and I own both shares of stock.

The Court: Severally?

Mr. Fried: Yes.

The Court: Each owns one share of stock?

Mr. Fried: That's right.

[fol. 9771] The Court: Now, what is your relationship officer-wise to Nazareth Enterprises, Inc.?

Mr. Fried: I am the president, your Honor.

The Court: Now, apparently Mr. Fried says that he doesn't own—it is not a wholly-owned corporation so far as he is concerned. He owns one share, and his wife owns one share of two issued shares of 100 authorized shares of stock.

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The Court: To wit, that he owns 50 per cent of the outstanding and issued stock, and that he is the president of the corporation and has been president throughout all the time involved herein.

Mr. Robbins: Well, the other fact is important.

The Court: That his wife owns the remaining 50 per cent?

Mr. Robbins: Right.

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[fol. 9841] The Court: All right, I will restate my question. Is there anything in the Bankruptcy Act which requires that an officer be removed because he trades in the stock of the debtor?

Mr. Robbins: Your Honor, the answer is no. There is nothing in the statute that requires his removal.

The Court: Now, that would include, therefore, that a violation of the proscription of 249, while it might involve no allowance either by way of salary or anything else or allowances to fiduciaries, it does not necessarily follow that a violation of 249 requires the removal of an officer. Isn't that so?

Mr. Robbins: That is right, your Honor.

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[fol. 9885] Direct examination of
Wilson D. Rehrig.

By Mr. Weinstein:

Q. Did you originally tell Mr. Philip all you wanted to spend for space in the grandstand building was $6200?

A. I might have said that was enough to spend, which was very—

Q. In your view that was sufficient for that space?

A. That is right.

Q. That is all you felt it was worth. Is that right?

A. That is right.

Q. And you told that to Mr. Philip. Is that right?

A. It could be right.

Q. And you instructed him to negotiate on that basis, didn't you?

A. That is right.

Q. Did there then come a time when it was reported back to you that management did not want to give you that lease for $6200 in view of the fact that we felt the space [fol. 9886] was worth more? Did that get back to you?

A. Yes, sir, and we had agreed upon $7500 later on.

Q. And when you say agreed upon, you mean to say that you had made up in your own mind that $7500 would

be acceptable in so far as you were concerned. Is that right? In other words, that was as high as you were going to go?

A. Well, I thought it was mutual.

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[fol. 9888] Q. At all events, the highest offer that you had made for space in the grandstand building was $7500 plus, as you say, making some improvements. Is that right?

A. Quite a bit of improvements. It would cost about $7000, close to $7000, which I did spend later on.

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[fol. 9890] Q. So that whereas you felt that you were not going to pay more than $10,000 as rental here, you took [fol. 9891] up the Judge's offer of $15,000, didn't you?

A. Because I had all my eggs in one basket.

Q. Never mind because, please; you took it up, didn't you?

A. Yes, sir.

Q. And you accepted it?

A. Yes, sir.

Q. And you have been doing business on that lease all the way through, haven't you?

A. Yes, sir.

Q. So that from your original lease of $6200, which commenced along about Labor Day of 1956, your present rental and the rental that you have been paying since 1958 on has been $15,000. Is that so?

A. Yes, sir.

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[fol. 9957] Cross examination.

By Mr. Rosen:

Q. Did you want any other competitor to come in the market outside of yourself in the meat business?

A. No.

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[fol. 9966] Q. I ask you a simple question: Mr. Rehrig, isn't it the fact that the reason to buy the additional stock

was to try to get the majority ownership, not to be a minority stockholder?

A. After I could not even get a voice, yes.

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[fol. 9995] Redirect examination.

By Mr. Weinstein:

Q. You just told Mr. Margolis, didn't you, that you felt that $10,000 was plenty for the space that you now occupy? Didn't you say that?

A. Yes, sir.

Q. And if you could use that voice on behalf of the debtor, you would not ask or try to get from yourself any $15,000, would you?

A. Not for that spot, no, sir.

Q. In other words, you would prevent that in so far as you were concerned; you would serve your own self-interest, pay only $10,000 despite the fact that you might get $15,000 on behalf of the debtor. Isn't that right?

A. Yes, sir.

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[fol. 10013] Melvin Lloyd Robbins, called as a witness in behalf of the respondents, having been first duly sworn, testified as follows:

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[fol. 10014] Direct examination.

By Mr. Weinstein:

Q. Mr. Robbins, you are the attorney representing Mr. Rehrig, are you?

A. That is right.

Q. And you have been representing him for some time, have you, in connection with this Nazareth Fair Grounds litigation?

A. Yes.

Q. Do you represent him on this particular hearing?

A. Yes, sir.

Q. You were in court yesterday, were you?

A. Yes.

Q. And you were representing Mr. Rehrig, weren't you?

A. Yes.

Q. Now, then, do you recall yesterday, during the course of the proceedings, you made a statement to this Court, and I quote, "These people are guilty of grand larceny"? Do you recall making that statement?

A. I recall making a statement that we had made serious charges of grand larceny.

[fol. 10015] Q. And also in connection with the statement that you say you made, were you referring to "these people" meaning Mr. Fried and myself?

A. Yes.

Q. And those charges of grand larceny refer to Mr. Fried and myself. Is that correct?

A. That is quite correct.

Q. Mr. Robbins, would you please produce any factual evidence or proof that you have that, as a consequence of any grand larceny that I committed in connection with the racetrack operations as you have alleged them in your petition on behalf of the petitioner, I received any cash, any check, any bond, security or thing of value?

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[fol. 10017] A. First of all, that petition is signed by me, which is an attorney's certification under Rule 11. So I am as much bound by it as the petitioner, Irving J. Wolf.

Secondly, I served on you, among others, a memorandum or schedule of testimony and exhibits which were incorporated by reference, and those pages and those exhibits contain in detail the information on which I based that petition when I drafted it, and that is all I know. Every single thing I know is in this record, and that is all I know.

The Court: Will you respond to the question, please. Mr. Weinstein asked you can you state any instance where he, Mr. Weinstein, received, and then he enumerated things of value, in connection with the operation of the racetrack.

The Witness: The answer to that, your Honor, is no.

The Court: All right, now my question. Can you state any instance where Mr. Weinstein aided or abetted or conspired with anyone else to receive anything of value [fol. 10018] in that connection?

The Witness: Your Honor, I refer to the testimony by Mr. Fried and Mr. La Grotte, which is referred to in the memorandum I just referred to, where my recollection is that Mr. Fried said that he had consulted with you, with Mr. Weinstein, and told you about the rent arrangements, both on his own failure to pay his proper rent on the racetrack lease, and on his having taken the La Grotte rents on the Sunday operations for himself instead of turning them over to the market.

By Mr. Weinstein:

Q. In connection with that latter portion about which you just spoke, do you have—and if you do—please produce it—any proof, any evidence, any facts, which would indicate that I received anything of value in connection with the statement that you just made about incorporating into evidence and referring to other proceedings or statements on my part in connection with the racetrack?

A. Nothing whatsoever.

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[fol. 10027] Arnold A. Weinstein, called as a witness in behalf of the respondents, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Weinstein:

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[fol. 10029] The Witness: • • •

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Thereafter, it was my policy, and I actually did make weekly trips to Nazareth, Pennsylvania, and during the [fol. 10030] first year or year and a half of those trips, they were for the most part trips made twice a week for the purpose of supervising the operation, examining into the operation, and to seek in every way possible to build this business up. Also to make order out of chaos wherever that could be done.

At the time of the filing of the petition and its granting in September of 1953, the debtor was insolvent. It couldn't meet its obligations when they became due. The credit of the debtor was practically nil. From my observation and speaking with people in and around the area of Nazareth, its reputation for respectability, especially in financial matters, was of the very, very lowest.

The operation itself—that is to say, the operation of the debtor's business in connection with the renting of space—I found that there was a poor class of merchants there. They were people who to my then unpracticed eye did not know the first thing about retailing, and I discussed that situation with Mr. Fried, and we adopted a number of policies.

The principal policy that we adopted at that time, and which we sought to put into effect was a program designed [fol. 10031] to educate the merchants who were there for the purpose of getting them to display their merchandise properly. For example, merchandise was being sold off old, broken and dirty tables. In company with Mr. Fried, and I should say that Mr. Fried did the vast majority of this type of work—I did it when I was out there only once or twice a week for the hours that I was there—we would go around to merchants and plead with them please to put a skirt or other attractive covering over these tables; point out to them that the attractive method which they might use to display their merchandise would attract more customers to them.

We also adopted the policy, and we kept directing our remarks out there to all these merchants, of trying to establish a reputation in and around the area of having the lowest prices in the entire community, and by community I mean anything within an area of possibly 30, 40 or 50 miles. So that people would have something to come to in so far as Nazareth was concerned, bearing in mind its old and dilapidated physical aspect and structure.

At that time there were on the premises three buildings. One of them was a great Dutch barn-like structure, very, very high ceiling. The building itself was probably four [fol. 10032] stories in height. also probably 75 years old

if it was a day old, rickety, cold, drafty, dirty, and we had to have something to attract people to come to Nazareth.

We struck on the idea of these cheaper prices, the quaintness of the atmosphere, bearing in mind that there were many Amish people, who were retailing merchandise there, that there are many Pennsylvania Dutch people in the vicinity, and that these people might find it attractive to come there because of these cheaper prices.

Now, during this time I spent—and this is general throughout the entire term of my office in so far as visits to Nazareth are concerned—as a general rule, I would leave New York City somewhere around 12 or 1 o'clock in the afternoon. I would get out to Nazareth some time around 3 or 3.30, depending upon traffic conditions. I would stay in Nazareth doing those things which I thought were necessary in connection with its promotion, discussion with Mr. Fried, observing Mr. Fried, checking on his activities, moving tables around, speaking to merchants, and I would stay there until along about 9, 10 o'clock at night, when I would leave and return to my home in Forest Hills. I [fol. 10033] estimate that the round trip is somewhere between 180 to 200 miles. From Nazareth to Forest Hills would take me somewhere in the neighborhood of two and a half to three hours in actual travel time.

Now, during this year and a half from September of 1953 until along about April or May of 1955, I performed these services in connection with the operation, supervision, promotion of the debtor, assisting Mr. Fried and supervising Mr. Fried, because the bulk of the work was actually done by him.

I did that without compensation whatsoever, other than the fact that I did receive from the debtor my travel expenses in going to and from Nazareth. I didn't always take those travel expenses. In many instances, because of the dire financial straits in which this debtor was, I paid my own money, paid my own expenses, and it was on some occasions that I did get the expenses that I actually had out of my pocket in going into Nazareth and back to New York.

During that period of time, we also adopted a policy of a money-back-if-not-satisfied. Now, this money-back policy if

[fol. 10034] not satisfied that we inaugurated at Nazareth was money back by the debtor in the event that people were dissatisfied with anything that they might have purchased in Nazareth.

At that time, as I pointed out, the merchants as a general proposition were of low caliber. They didn't quite understand the virtue of reliability, of standing behind their products, and we were trying to establish that kind of reputation in so far as Nazareth was concerned.

In connection with that, I remember on many occasions when I was in the office with Mr. Fried, discussing the very, very many problems which we had, which included keeping creditors off our backs, trying to keep creditors happy, pushing one off, paying one, postponing another, to keep this ship from rocking too badly so that it would sink completely, there would be many occasions when people would come into the office and complain that Mr. X or Mr. Y, from whom they had purchased merchandise, had sold them or they didn't get what they were supposed to get. I used to refund money out of my own pocket to these people. I saw Mr. Fried refund money out of his own pocket to these people, and they went off happy, and they [fol. 10035] went off satisfied. We would try to get reimbursement in so far as the individual merchants were concerned, but in most instances, we met with failure.

When matters like that kept repeating, we tried to weed out this bad type of merchant so that we would get people in there who would satisfy us in our desire to set up this market the way we wanted it to be set up.

While all of this is going on, I had at the same time the burden and the obligation of complying with the order of this Court in the payment of the obligations of the debtor in so far as the actual issuance of checks in payment of those obligations was concerned. Weekly I prepared an affidavit with respect to every expenditure which was made by the debtor. I examined all of the check vouchers in payment of these obligations. I checked through them. Where there was any doubt in my mind as to any of these payments, I would check either with Mr. Fried, with the accountant, and there were many times that I had to make

those checks, delivered those checks to Referee Joyce, who was designated to countersign all checks, left them there, picked them up the following day or the day after, brought [fol. 10036] them back to the office, sent them out to Nazareth by mail, or if I was going out the following day, then I would take them out with me.

I would say that the matter of checking into the payment of the debtor's obligations, preparing an affidavit, submitting it to Referee Joyce, checking it up after he had countersigned the checks, would take me every single week, would consume approximately two hours of my time. And that I think is an underestimate.

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[fol. 10038] Direct examination of Gilbert Sunshine.

By Mr. Weinstein:

Q. Now, then, would you direct your attention to the report for the year ended June 30th of 1953?

[fol. 10039] A. Gross income for that year was $56,633.58. The profit for that period was $11,192.13, after provision for depreciation of $4200-odd. In addition, that profit was predicated upon the recoupment of an insurance claim of $11,811.78, which sum never was received by the debtor.

Q. Will you turn to the report for the year 1954, ended June 30th?

A. The gross income for that year was $61,949. The profit at that time was $2,317 after depreciation of $5,100 or a total profit of $7,376.

Q. Will you repeat the same information in so far as the following year, 1955, is concerned?

A. The gross income at that time was $66,558. The profit was $8,442. There was approximately $6,600 in depreciation, or a total of $15,088.

Q. And for the following year, 1956?

A. The gross income in 1956 was $78,981. The loss for that period was $531 after depreciation provision of $7800 or a net profit of $7243.

Q. Now, you said something about the year 1957 with respect to some scratch sheets that you have?

A. Yes. I took the wrong sheet with me.

Q. Can you tell us from the sheets you do have what the [fol. 10040] situation was with respect to that year?

A. The gross income was $94,578. I am not sure which is which, but I think the profit was $3,298 and the provision for depreciation was $3,693, bringing it up to a total of $6,982.

Q. That report covering the year 1957, covered the period of August 28 of 1956, did it not?

A. Yes, July 1, 1956 to June 30, 1957.

Q. This corporation runs on a fiscal year basis. Is that right?

A. Correct.

Q. And the date that I mentioned to you, do you not know was the time when the premises of the debtor were substantially destroyed by fire?

A. That is right. That figure includes the rental insurance that we collected from the insurance company.

Q. Would you say that in light of the fact that there was this fire and in light of the fact that we collected rental insurance, and had other incidental expenses in connection with the operation of the premises, and the damages as a consequence of the fire, that that figure that you gave us is not a truly representative figure of the debtor's oper- [fol. 10041] ations for that year?

A. Well, it was not a representative year because we only collected approximately six or seven months, when we had no activity whatsoever, nothing but expenses.

Q. The following year would be 1958, would it?

A. That is right.

Q. Would you please give us the information on that?

A. In 1958 we had depreciation of $15,000. I should have gone back. The income in the year 1958 on an adjusted basis was $146,014. The profit for the period was $44,032. Depreciation was $15,000, which would be a total of $59,000. From that figure, $18,000 would have to be subtracted from the adjusted rents, which were never actually collected in cash to show the net cash position of $38,000, $38,000 cash profit.

Q. With respect to those adjusted rents that you just mentioned, would you explain to the Court what you intend to convey by the expression "adjusted rents"?

A. Adjusted rents means that certain advance rents had been received from tenants under lease and under other [fol. 10042] arrangements under the building program, and these were being amortized by reduced monthly rents received in cash by the debtor.

Q. So the adjusted rentals are the actual rentals received in cash for the period. Is that the idea?

A. That is right.

Q. And constructively in that particular period, had there been no advance payment of rents by any of these tenants, the figure for rental collections would have been higher. Isn't that correct?

A. That is right.

The Court: Are the figures for 1959 available?

The Witness: Yes, sir.

Mr. Weinstein: I am coming to that.

Q. With respect to the year 1959, would you give us the same information as you did for the previous years?

A. The gross cash rents were $158,460. On an adjusted basis they were $167,966. The profit for the period without the rent adjustment was $15,352. Provision for depreciation was $16,400, and the adjusted rent difference was $9500. Total profit was $41,269. This would have been [fol. 10043] after a payment for interest of $8900, the prime portion of which was applicable to the first mortgage that had been obtained. In the previous year there had been a similar payment of approximately $7000 for interest.

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Q. At the early stages of this reorganization, back in September of 1953, do you know whether or not in connection with the operation of the debtor's business and the [fol. 10044] payments of its bills, whether it was ever in a position to obtain purchase discounts on any items for which an expenditure was incurred?

A. Not with maybe an isolated example up until I think the year ending June 30, 1958, and that year we took in $45.75 in purchase discounts.

For the year ending June 30, 1959, the discounts rose to $750.94. And during that period, my recollection is that every bill has been discounted.

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Q. Have you noticed in your visits to the Nazareth Market from time to time, for the purpose of auditing its books, whether there has been any change in the type and the character of the operation out there as regards rentals, leasing, persons in attendance or the like?

A. The market is no longer run as an itinerant business, which is what it was when this debtor first went into reorganization. There are a number of lease tenants. There are a goodly number of tenants on a percentage basis, [fol. 10045] and the number of tenants who come in for one month and disappear has been reduced tremendously.

The ratio of occupancy is up considerably. It is well beyond the 80 to 90 per cent. The amount of money coming in from rent collections is reasonably constant. We don't have the great rise and fall where we would collect money one month and the next month it would drop down to nothing, and we would wait for the few months in the summer for some money to come in.

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[fol. 10055] Cross examination.

By Mr. Rosen:

Q. Did you have a discussion with Mr. Fried and Mr. Weinstein as to why the reduction was being made in a rental of 15 per cent down to 10 per cent?

A. Not only in his case, but in any others that come to my attention where rents are reduced.

Q. In other words, there were other instances where rents were reduced for tenants here?

A. It was constantly happening.

Q. Explain it to the Court. Tell us why they were reduced in some instances, why that was done in the custom and operation of the business?

A. In many instances, tenants, in order to maintain them, if they weren't profitable, and it was believed to be in the

interests of the operation of the market to keep the tenant in the property, concessions were made to many tenants over a period of time.

Q. In other words, would this be correct:

If you had a vegetable man operating and it appeared that he couldn't maintain the rent that was agreed upon, that an adjustment was made in order to keep him in the premises and keep the premises rented?

A. Yes, sir.

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[fol. 10066] Cross examination.

By Mr. Robbins:

Q. Did you ever discuss it with Mr. Seligson?

A. I don't know. I think Mr. Mandel was aware of it.

Q. When was that?

A. When he came into the case.

Q. Can you be any more specific about that?

A. No, sir. Mr. Mandel asked an awful lot of information when he first came in here, and he went into the subject of the lease of the racetrack, and I am sure it was called to his attention, but I can't tell you when or how. Most of our conversations were on the phone.

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[fol. 10094] ARNOLD A. WEINSTEIN, resumed.

Direct examination.

By Mr. Weinstein:

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[fol. 10096] The Witness: We planned a structure which would connect the two buildings that I described, and for the reasons that I gave previously. Plans were drawn. This Court was asked for approval to put up this building. In connection with the putting up of the building, I arranged for a client of mine to advance some $16,000 or $17,000 or $18,000 on the security of a third mortgage. I

made no charge to the corporation for that. The money was loaned. We put this building up. I think the cost was $32,000. Its replacement value for insurance purposes was something in the neighborhood of $60,000 to $70,000, for which we carried insurance, and we put this structure up.

Mr. Fried superintended that construction for the most part, if not completely, and we put this building in operation.

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[fol. 10097] I estimate, based upon the figures that I have seen, knowing about the cost of operation being $32,000 and the replacement value of some $60,000 or $70,000 on the basis of which I might say by anticipating myself, that it was on the basis of I believe $60,000 to $70,000 that we settled a fire loss on that building a year or so later, but as a consequence of that construction, this debtor not only got [fol. 10098] the benefits of the construction of eliminating fluctuating income, but in addition it got a building worth 60 or $70,000, and in that respect having only cost the debtor $32,000, I feel that the estate itself was enhanced by the difference between those two figures.

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[fol. 10100] We then come to the period of 1956, and I [fol. 10101] should say that throughout the entire period of my being the president of this corporation that, weather permitting, my health permitting, and possibly the health of my family permitting, I have gone out to Nazareth checking over the operation, speaking with Mr. Fried, speaking with tenants, going over the advertising, suggesting whatever I possibly could to him to improve wherever possible the operation that we were conducting.

The Court: How frequently?

The Witness: I would say, your Honor, that on the average that would be once a week, once in nine days, depending upon how the situation turned out.

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[fol. 10104] Mr. Fried began to scout around with plans, consulting architects, consulting material men, consulting

excavators and all those individuals who would go to put up a structure, and checked back with me.

We finally got to the point where we applied to the Court for permission to put up a new structure larger than the one that we had before containing, I don't know, somewhere in the neighborhood of 60, 65,000 square feet, and the figure that it cost us actually to put up this new structure approximate about $220,000.

This is to be compared to estimates that we had received from Bethelehem Steel Company, I believe it was, and some other people who were engaged in the construction business in and around that area, estimates which ranged for the exact same structure Mr. Fried superintended and actually put up, estimates ranging as high as $450,000.

The fact of the matter was that despite expert testimony given in this court on the hearing with respect to the reconstruction, a witness brought in by Mr. Margolis I believe, who testified that that building could not be put up [fol. 10105] much less than $6 a square foot, which would have put that cost at somewhere in the neighborhood of $360,000, nevertheless, we—when I say we, it is 90, 95 per cent Mr. Fried and maybe 5 per cent myself as far as construction was concerned—got this thing up for $220,000.

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[fol. 10115] I should like to conclude that branch of my testimony by saying that other than any Court approved payments which I might have received from the debtor beginning in April or May or so of 1955, I did not receive one single, solitary cent out of the operations of the debtor, that I made nothing out of any lease arrangements. I made [fol. 10116] nothing out of any of the unauthorized transactions about which much has been made here, and that everything that I have done has been with only one thought in mind, and that was to build up this debtor for one thing and, second, to get it out of reorganization as quickly as possible so that the debtor, its stockholders, could make some money out of this thing after so many years of waiting. It is the only thing I have had in mind.

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[fol. 10121] The Witness: I had concluded yesterday's testimony at the point where I stated that Mr. Robbins represented himself to myself and Mr. Rosen as the attorney for Wilson Rehrig, a tenant who had purchased some stock in the Market; that he wanted to ascertain whether or not some sort of lease arrangement could be entered into in so far as the debtor was concerned with Mr. Rehrig.

So in line with that and in line with an arrangement that [fol. 10122] had been made by Mr. Robbins and with Mr. Robbins, we went out to Nazareth. I met with Mr. Robbins, Mr. Philip, who is Mr. Rehrig's Pennsylvania lawyer, Mr. Fried and myself in a diner which is substantially across the street from the Market out there. And we began to talk lease.

Preliminarily, as I recall it, Mr. Philip, I should say, undertook the laboring oar, and he offered $6000 for the space that Mr. Rehrig was then occupying, and he was looking for a long term lease. By long term I think there was something mentioned about maybe five years, maybe ten years, somewhere in there.

The Court: Just to refresh me on this, when was this meeting?

The Witness: This meeting, your Honor, was somewhat before the summertime of 1957. I recall it was at a time—

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[fol. 10123] The Witness: And, as I say, there was this talk about possibly negotiating out a longer term lease. In the course of the conversation, Mr. Philip suggested that Mr. Rehrig might also require some additional space and a 12-foot area was mentioned.

That 12 feet would have amounted to approximately 450 to 480 additional square feet because it would have been 12 feet in length by approximately 39 or 40 feet in width, which was the width of the grandstand building.

Well, at that point Mr. Fried and I resorted to some quick figuring on a sheet of paper, and we said something to the effect that, well, if that additional space were required, the rental for it would and should be $7200 a year.

The Court: For the entire?

The Witness: Yes, for the space that he then occupied with the additional space which was requested.

When that figure of $7200 was mentioned, Mr. Philip became very, very excited. He said to Mr. Fried, "What are you trying to do? Are you trying to sandbag me and [fol. 10124] push me around the way you are pushing around other merchants?"

He said, "Listen here, young fellow, you can't do that to me," in words or substance. He said, "I know all about you."

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I finally got a little order restored there, and I said, "Look, fellows, let us sit down here and see if we can't talk this thing over reasonably." And I addressed myself to Mr. Robbins. I said, "Look, you are asking for some additional space. Mr. Fried and I just calculated out what we thought was the additional amount of money that you ought to pay."

I said, "Now, I want you to understand that this is based substantially on similar rentals which are being paid [fol. 10125] by another butcher in the Market." At that time I think the butcher was Steever & Achey.

And I believe that we measured out for him some of the space that Steever occupied there, and we pointed out to him that this was what we considered to be fair under all of the circumstances.

Well, there was no holding Mr. Philip in check. He said to Mr. Fried, "Look, I am not going to buy any of that kind of nonsense here at all."

He said, "Wait until I get through with you." He says, "I am going to blacken you. You are going to give me the lease I want."

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[fol. 10126] The conversation finally got back to this Rehrig lease situation, the Rehrig general situation. Mr. Robbins said, "Look here, I am representing a client here."

He said, "I have got to get a lease."

He said, "I want you to know that if I am going to represent this client, I am going to keep this reorganization in [fol. 10127] existence and delay it long enough to tire out

every single stockholder, pick up the stock cheap, get control of this corporation, and I am going to get Mr. Rehrig the lease he wants at the rental he wants to pay and the location he wanted."

I was flabbergasted at this. I remonstrated with him. I tried to talk with him. I tried to point out to him the inconsistency of this kind of thinking.

I pointed out to him that he was a comparatively young lawyer. I said, "Where do you fit in, to sit on two sides of the fence at the same time? How can you come in here and tell me that this is what you are going to do for the purpose"—one minute he was talking representing him as a stockholder. The next minute he was talking about representing him as a tenant, and the end result was that he was going to go ahead and get for his client, wearing then the hat of a tenant, the best possible deal that he could get, and the devil take the debtor.

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[fol. 10133] The Witness: We then attempted to get together further on a negotiating basis with Mr. Robbins in so far as a lease for Mr. Rehrig was concerned, and there was an additional proposal, which had been advanced I believe by Mr. Philip to the effect that the $7200 that we had asked for would be acceptable, provided the debtor made certain repairs to the premises—I don't know, maybe four, five, six, $7000—the amount of which escapes me, and that the offer was also made that the debtor would not be required to extend its own funds for the purpose of making these repairs or alterations, but that they would be advanced by Rehrig, and that there would be a reduction over the period of the long term lease so that Mr. Rehrig's rent would be reduced, and in that way he would then get back the money that he had or would have expended for the alterations.

Well, now, this was refused, and it was around that time [fol. 10134] that I was present in Mr. Rosen's office when there was some conversation about this particular proposal.

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[fol. 10135] We then had another conversation, this time I would say in the spring of 1958, and it was along about the time that there was some hearings which concerned themselves with the stock claims that were going on.

Mr. Fried had reported to me that he felt that he could get $9000 or $10,000 for that space, that an offer had been made to him I think for $10,000, by his then landlord, who was a butcher. We had lunch one day during one of the recesses, and I think Mr. Robbins joined us.

The Court: What do you mean by his then landlord—where he resided?

The Witness: Yes. Mr. Robbins was invited to join us, and in the course of the conversation, we told him that we had this offer, that we were seriously considering it, that if Mr. Rehrig wanted to take it on that basis, why, we [fol. 10136] would be only too happy to talk with him about it, and he felt that Rehrig would not go for it, and that was that.

In the meantime, we are getting closer to the point where Mr. Rehrig's lease was coming to its expiration. We are now coming to along about May or June of 1958. At that point there was a conversation that I had with Mr. Fried, and I said, "Look, Jerry, we can't afford to gamble on this thing any longer. We have been playing with this thing a long time."

I said, "Please go out and scout around and dig up for me a tenant who will pay the highest price we can get for that space," which Mr. Fried did.

He ultimately came up with a tenant who was willing to pay $15,000 for that space. At about that time, Mr. Robbins, acting on behalf of Mr. Rehrig as a stockholder, called a meeting of all stockholders, an informal meeting, to discuss the general administration of this debtor, the matter of the lease, to be held at the Bar Association Building up here on 44th Street.

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[fol. 10138] He said, "And I am going to go ahead and blacken you so that you are going to back down, and you are going to give us the lease that we want."

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[fol. 10140] Now, at that point or shortly before that time, we had gotten an offer of $15,000 for the space that Mr. Rehrig occupied.

[fol. 10141] The Court: Plus the additional?

The Witness: I beg your pardon, yes, sir, plus the additional space on an as-is basis.

That was communicated to Mr. Robbins. He said that his man would never pay that kind of money, didn't believe we had the offer, and refused to pay it, and I said to him, "Look, it leaves us no alternative. This man has been there a long time. Nobody wants to boot him out of there, but as we have this offer of $15,000, which is so much more than your man is willing to pay, we are going to be bound to take it."

Ultimately, the matter of the $15,000 lease was submitted to this Court. Some security was insisted upon, both in connection with the terms of the lease, and after that I think the Court will recall that he gave the opportunity to Mr. Rehrig to match that lease, which Mr. Rehrig did at that point.

We signed the lease. That is the lease under which Mr. Rehrig is now in possession.

In general, what I have testified to respecting the lease this morning, the conversations that I had, the threats of exposure to tell the Judge about my conduct, to tell the Judge all about Mr. Fried's conduct, that represented sub-

[fol. 10142] stantially the background of any stock acquisition that I made myself. I knew that these people were out to get control. I knew that this was an adverse interest. My experience in negotiating a lease with these people indicated to me that they were not willing to pay the rentals which were being offered by other people, that they wanted special and preferential treatment, that there was a request made for a semi-monopoly of the sale of meats at the Market. I should say almost a complete monopoly in so far as the caliber and type of meat that Mr. Rehrig was accustomed to sell, as distinguished from the meat that the other butcher at the Market, Mr. Steever, had, who sells a different and better grade of meat.

To me, I felt that I was under an obligation to stop any kind of acquisition, of control by an adverse interest in

the form of this tenant. I did not at any time ever solicit any stock. I never approached anybody and said, "Let me have your stock."

It was only in situations where Mr. Rehrig, through his agents, was making attempts to purchase stock, that when stockholders came to me and told me about it, I told him to hold on to his stock, not to sell their stock, to stay right [fol. 10143] with the situation.

I was hoping that this thing would be getting out of reorganization. In some instances, the stockholders abided by my suggestion. In others, they didn't, and the proposition was put to me: Well, look here, the Rehrig people have made us an offer.

In the case of Dorothy Holober Clark, she said that she needed some money for the purpose of sending her youngster through college; this was her last year, she needed the money very badly; unless I did something about the situation, she was going to have to sell it to Mr. Robbins, representing Mr. Rehrig.

Well, I arranged on behalf of myself and Mr. Laupheimer, who is a co-director of mine, to purchase that one share of stock.

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The Witness: I should say this, at this point, that I felt my obligation to be at that point to do everything that was in my power to stop this butcher from in effect plucking [fol. 10144] this debtor. I didn't know anything at all about Section 249, with the prohibitions that it contained. The only thing I knew was that here I had somebody who was trying in effect to take over this corporation for his own private interests, and that this would be to the complete detriment and the damage of the debtor and its stockholders; that this man was an adverse interest in the sense that if he controlled this particular debtor, he would be in a position to deal with himself, and he could go ahead and, as the controller of this corporation, give himself the best deal possible.

I had in mind, to be sure, that there was a limit to which this man could go in so far as dealing with himself was concerned during the reorganization. I knew that this

Court would not ever stand for anything that smacked of that kind of skulduggery, but my thinking went beyond that. That was not the main proposition because we don't expect to stay in reorganization forever. There is going to come a time, I hope, that when we get out of reorganization, we can operate this business—

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[fol. 10145] The Witness: As I say, it was not only what Mr. Rehrig could or could not do within the framework of this reorganization proceeding, but I envisaged the future. If this man, as a consequence of his control of what-[fol. 10146] ever stock might possibly be validated by the Court in the future, this corporation and its stockholders could be a sitting duck, and there would be no Judge Sugarman to hold him in check.

There would be minority stockholders here, who would be in effect at the mercy of an adverse interest.

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[fol. 10160] Now, as far as the reduction in Mr. Fried's lease was concerned, this I felt was something that was in the ordinary operation of this debtor's business. This was not something that I had not done before with anybody else. There had been reductions made in other people's situations. For instance, there were many times when, because of a competitive situation or because of the impact that a strike might have on particular kinds of businesses, more especially hard goods as distinguished from food, which people require, that Mr. Fried would come over to me and say, "Here, what are we going to do about this poor guy here," referring to a tenant or a merchant.

"He is a good man; we would like to have the department here. What can we do?"

I said, "Look, Jerry, make the best deal you possibly can. Cut it a little bit. Maybe give him a concession here and there, but keep him in business" because in the cases of the tenants he had spoken of, I had seen these people operate, they were all right, and we certainly did not want a situation where we had empty spaces in that Market. We [fol. 10161] wanted it to be a one-stop shopping center

where people could come and get all of their wants, satisfy themselves, without going elsewhere.

I felt that if we are running the business, I certainly could do that. I certainly had in mind that we originally, under the order of Judge Holtzoff, were permitted to operate this business, and the only way I knew how to operate this business was to keep it rented under the best possible terms I could keep it rented.

I might also add, too, that we have waived benefits that we were entitled to under arrangements with various tenants. I should also say they did the same thing for Mr. Rehrig. There was no distinction as far as he was concerned. His present lease, for example, as a specific term, recited the fact that he was obliged, barring acts of God—and this is in a number of the leases that we have there—that he was obliged to keep his premises open on regular market days. The reason for that, if I may go into it for just a moment, is to insure that we have merchants operating there at all times so that any of our customers, when they do come there, are not going to be disappointed, that [fol. 10162] Mr. Joe Blow or Mr. John Smith are not open for the purpose of catering to their wants, and so that the general feeling might not be engendered that, well, we can't rely on Nazareth; half the time the merchants are not open and we might just as well go some place else, and there are plenty of places where they could go.

So his lease requires him to stay open, and lo and behold, this past year here, Mr. Rehrig closes up on a Friday and a Saturday. Now, I conceive that the debtor might have had some remedy in so far as that situation was concerned. Maybe damages, maybe something, I don't know, but, all right, maybe the man felt he had to be closed, maybe he had some particular personal reason. I certainly was not going to start a revolutionary war about the thing, let the thing go.

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[fol. 10163] I should say this, that in making this reduction from 15 per cent to 10 per cent under the terms that I have outlined here, I did not benefit by that one single, solitary cent. I didn't look for anything. I was not entitled

to anything, and I didn't get anything. This meant absolutely nothing to me except that it was in the line of the obligation that I undertook to run this debtor the best way I knew how, to protect it and to run it, so that ultimately the people who were going to own this debtor's business, are going to have something here—the only possible reason that I did it for, and the only reason.

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[fol. 10165] Cross examination.

By Mr. Robbins:

Q. Mr. Weinstein, if I understood you correctly, you say that the major problem Mr. Rehrig presents in his purchasing stock in the Market is that this might possibly put him in a position where he would be both landlord and tenant, and he would be dealing with himself in making a favorable or preferential lease to himself. Is that the idea?

A. My position is that, based upon his conduct, that he would give himself the better of any deal were he permitted to deal with himself.

Q. So it is this conflict of interest, in view of his past behavior, that you predicate as to what he would do that presents a conflict that you are trying to prevent. Is that right?

A. Yes, sure.

Q. What is the difference between Mr. Rehrig's future or hypothetical situation and Mr. Fried's actual situation now?

A. In what respect?

Q. Isn't Mr. Fried on both sides?

[fol. 10166] A. Mr. Fried has never sought a preferential lease. That is the difference.

Q. Let us start one step at a time. In fact, isn't Mr. Fried on both sides with an actual conflict of interest?

A. No.

Q. He is not?

A. No, sir.

Q. Secondly, you say Mr. Fried has not, in fact, sought any preferential treatment as a tenant?

A. Not when you are talking within the framework of comparing him with Rehrig.

Q. Let us put Rehrig aside for a moment. Has Mr. Fried sought any preferential treatment as a tenant, to your knowledge?

A. I would say no to that.

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[fol. 10171] A. Yes, the change took place this way. Mr. Fried was pointing out to me at that time that he, in conducting the races, was under no obligation to turn over any food percentage to the Market, but that he was doing it [fol. 10172] any way because the Market needed money.

Q. This is what Mr. Fried told you?

A. He not only told it to me; he did it.

Q. Then there came a time in 1954 and 1955 when Mr. Fried told you that henceforth, he would collect La Grotte's rents on these Sunday sales?

A. Mr. Fried told me he could no longer operate these races under those circumstances, and that he was going to go ahead and keep the food concession percentage or money in those situations where he paid 15 per cent.

The Court: This change or the relinquishment by Mr. Fried of the voluntary payments, was it coincidental with the arrangement that he pay 10 per cent and increase the purses?

The Witness: Oh, no.

The Court: That was long before?

The Witness: That was long before, your Honor.

The Court: All right, go ahead.

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[fol. 10173] The Court: Mr. Robbins, I fail to understand the thrust or significance of your questions.

If the Nazareth Enterprises lease provided that if Nazareth Enterprises paid 15 per cent of its take, it was entitled to any emoluments arising out of the sale of foods in the Market on race days, and despite the fact that it might have voluntarily not taken those emoluments, despite

the fact that it paid the 15 per cent and then subsequently decided that it no longer wanted to make that gratuity to the debtor, but that it would pay it 15 per cent and take [fol. 10174] emoluments from the sale of food, why would it have been necessary, if that was the provision in the lease between the debtor and Nazareth Enterprises, for the Court to be informed about that?

I am serious about the theory on which you are predicating these questions, unless I misunderstand the agreement.

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[fol. 10194] Q. Do you remember any discussion with Mr. Rosen about that change in paragraph 3 of Debtor's Exhibit AI in the Jerome Fried creditors claim?

A. I remember that there was a discussion by Mr. Fried, and I should also point out that there were a number of discussions about this prior to the actual typing up of this document, and that there were discussions even after the document was completed.

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[fol. 10195] Q. Do you know whether Mr. Rosen asked for an explanation of the difference in definition?

A. I don't recall anything like that at all.

Q. And you did not ask for advice about this?

A. I wouldn't say that either. The fact of the matter is that I am not at all certain that this was even the final agreement that we were supposed to submit because, as I remember it now, Mr. Rosen was holding that thing I think on a promise to Mr. Fried to hold it in escrow because he [fol. 10196] wasn't so sure Mr. Fried, despite the fact that he signed it, that he wanted to go through on that kind of a change.

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[fol. 10204] Q. Mr. Weinstein, did Mr. Rehrig ever ask [fol. 10205] you for an exclusive on the sale of fresh meats at the Market exclusive together with Mr. Steever?

A. He never asked me.

Q. Were you ever informed by Mr. Fried that he asked Mr. Fried for an exclusive?

A. Yes.

Q. Do you remember your ever having given any reasons for denying an exclusive to Mr. Rehrig and Mr. Steever?

A. I don't recall having given any reasons. I did have reasons.

Q. Would you care to tell what those reasons are?

A. Yes. The policy of the Market, as we have set it out, is to try to insure prices as low as possible, to insure that we would attract the business of all the people in the surrounding area. It is my feeling that were we to give to one particular individual a monopoly, more especially with respect to meat which, as I have observed, is probably one of the most active kinds of businesses in a Farmers Market, to give such a monopoly, you are defeating your purpose with respect to maintaining a lower level of price.

Where you have competition, two things come into op- [fol. 10206] eration: To begin with, competition, in and of itself, is a healthy thing. I don't wish to go into the economic theory behind that. But, in the second place, where you have competition, you do have a striving on the part of the competitors to render better service at the lowest possible prices so that they would be in a better position to compete with each other and attract the customer for goods.

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[fol. 10268] Redirect examination.

By Mr. Weinstein:

The Witness: The date was suggested to me of May 7, 1957, at which time I superintended a transaction in connection with the acquisition of some shares of stock in Nazareth on behalf of my sister, Blanche Waldman. I wish to state that at that time and prior to that time, I had received information with respect to the fact that there was an attempt being made to purchase stock on the part of Rehrig.

The Court: Hasn't that all been put in the record in connection with your sister's claim?

The Witness: I don't believe so.

The Court: All right, go ahead.

The Witness: That while I had information from Mr. Masur, Mr. Buckwald, a lawyer, to the effect that a so-called Philadelphia group was trying to buy control of this Market or pick up some of its stock, I am reminded that I did receive a telephone call from one of the stockholders or alleged stockholders or creditors in this proceeding by the name of Morton Samut to the effect that he had been advised by one Richard Hull that he was buying stock, he meaning Richard Hull, or attempting to buy stock on behalf of a butcher out in Nazareth.

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[fol. 10315] Direct examination of
Jerome Fried.

By Mr. Weinstein:

Q. Now, let me go, Mr. Fried, to the transaction in which I acted as your agent in the acquisition of shares of stock or alleged shares of stock in this corporation which were then held by Dorothy Clark, her husband Barry Clark, and Lazar Karapontso.

A. Yes.

Q. You bought that stock, did you?

A. Yes, sir.

[fol. 10316] Q. How much did you pay all told for that stock?

A. For the group?

Q. Yes.

A. $8000.

Q. And where did you get the money?

A. Some of it I had, and I borrowed approximately $4500 or $5000.

Q. From whom did you borrow it?

A. Friends of mine.

Q. Can you name them?

A. Yes.

Q. Would you please do so?

A. Dr. Thompson, Dr. Frank Thompson.

Q. Anybody else?

A. Fred Tedesco.

Q. Yes.

A. Pat Ronco, and some from the Second National Bank.

Q. That would be the Second National Bank in Nazareth?

A. In Nazareth, yes.

Q. Now, then, at the time that you made your purchase did you know that Mr. Wilson Rehrig through his agents, or his attorneys, or his employees, were attempting to [fol. 10317] purchase that stock?

A. Yes, indeed.

Q. Was that the reason why you went out and you borrowed money for the purpose of purchasing that stock?

A. That was the only reason.

Q. Did you solicit the purchase of that stock?

A. On the contrary.

Q. What do you mean by "On the contrary"?

A. I tried to tell these people, as I recall, not to sell their stock at all, not to us and not to the other people.

First of all I did not feel like I wanted to buy it because I did not have the money to put up and it meant going into debt for it, and I just felt, because we discussed it with them more than one time, too, and we thought that perhaps maybe they would not sell at one point, but they decided that they needed the money and they sold, and this was only due to the—well, I think that there was an agreement that we had agreed to, the first refusal agreement, and there were two or three people in it.

Q. Were you told in connection with that purchase by the seller that if you did not buy it, or anybody connected with management, that they were going to sell it to Mr. [fol. 10318] Rehrig?

A. Absolutely, they told us that.

Q. They told you that they had received offers for your stock from Mr. Rehrig?

A. Yes.

Q. Through his agents or his lawyers?

A. That is correct.

Q. Well, how much do you recall them having told you that they had been offered by Mr. Rehrig through his lawyers for the sale of that stock?

A. As I recall, I think they offered him a thousand dollars a share.

Q. And that was the price—

A. And, as I recall it, we had to meet their price.
Q. And that was the price that you paid?
A. That is right.

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[fol. 10320] Q. Now I also show you, Mr. Fried, three photographs, and I ask you whether or not these represent fairly and correctly pictures of the stores or institutions which are in competition with the Farmers Market in Nazareth, Pennsylvania, at the present time?
A. These are just a few of them, but these are correct.

Mr. Weinstein: I offer these photographs in evidence.
[fol. 10321] Mr. Robbins: May I inquire of the witness as to these, your Honor, for a moment or two?
The Court: Surely.

Preliminary cross examination.

By Mr. Robbins:

Q. Mr. Fried, I refer to the photograph of the Acme Market.
A. Yes.
Q. Where is that located?
A. Directly opposite the Nazareth Fair Grounds.
Q. And with respect to the photograph, Two Guys from Harrison, where is that located?
A. What do you mean, just in mileage, do you mean?
Q. Both.
A. Well, it is—I don't know exactly. It is the Township of—
Q. Well, is it just outside of Allentown?
A. Yes, it is outside of Allentown.
Q. And how many miles from the Nazareth Market would you say?
A. Maybe about seven or eight miles.
Q. And what about this one here, the Woolworth store?
A. That is in the shopping center.
[fol. 10322] Q. Where is that located?
A. Less than five miles, roughly.
Q. Where?
A. In Easton, Palmer Township.

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[fol. 10370] Cross examination.

By Mr. Robbins:

Q. Did the debtor reduce any rents?
A. Yes.

The Court: Just a minute.
Mr. Robbins: Excuse me.
The Court: Has the rent of any tenant been reduced during the past two years?
The Witness: Yes, sir.
The Court: Whose rent?
The Witness: I think in the last two years in the case of—
[fol. 10371] The Court: Whose?
The Witness: We had—I believe we had four produce departments in particular that I can think of right now where we reduced the rent.
The Court: What were the names of the tenants?
The Witness: Joseph Wanko, Sam Margolis, Charles Klein and David Katz.
The Court: Now, within the past two years or thereabouts, has the rent of any or all of those four been reduced?
The Witness: All four.
The Court: Now, has the rent of any other tenant other than those four been reduced during this period, in the last two years approximately?
The Witness: Well, first, may I say that in the case in which the rents were reduced we had first increased it and then—
The Court: I didn't ask you anything about that.
The Witness: I am sorry.
The Court: We will come to that. I want to know if the rent of any tenant other than the four you have men-
[fol. 10372] tioned has been reduced in approximately the last two years so far as you can remember?
The Witness: I can't recall.
The Court: All right. Now, what were the circumstances under which the rent was reduced as to each of the four whom you have named?
The Witness: Well—

The Court: Take them one at a time unless it was done jointly.

The Witness: I think it was a joint thing, your Honor.

The Court: All right. Give us the background, the circumstances, just what happened that brought about the reduction.

The Witness: At one time before the reduction we were charging the produce departments I think it was $6 a front foot and—

The Court: Incidentally, Mr. Fried, did any of these people, or all of them, have written leases?

The Witness: No, sir, not at that time.

The Court: What arrangement did you have with respect to each of them?

The Witness: No particular—no arrangement, except that they paid their rent monthly, and that was it.

[fol. 10373] The Court: Well, they were payments from month to month?

The Witness: Yes, sir.

The Court: They were not like the tenants who came in overnight?

The Witness: No, nothing like that.

The Court: That Mr. Weinstein spoke about.

The Witness: No, sir. These people had been with us for several years.

The Court: All right. Then take it from there.

The Witness: Yes.

At one point we charged $6 per front foot, and then we raised the rent to $7 a front foot.

The Court: $6 a front foot to $7 a front foot for what period?

The Witness: Every month.

The Court: In other words, if a man had 70 feet he would have been paying $120 and then later on $140?

The Witness: Right.

The Court: All right.

The Witness: Then we raised it again, another $1 per [fol. 10374] front foot which brought it up to $8 per front foot and that I think was in July of about 1958. I believe that is what it was, of July, 1958.

The Court: Yes.

The Witness: We raised the rent to $8 a front foot.

We rented during the month of July when business was very good, and then in August it looked like the bottom just fell out of everything for produce men particularly simply because in our particular area there is a lot of home grown items and we have—we only have one merchant who sells his home—who sells his own home things in the Market, but all of those stands were open and the farmers were selling things. They had a bumper crop that year and we just could not compete with them as far as the ones who must buy their produce at the Philadelphia ports and so on and bring them up to Nazareth.

So at that point the merchants, and I mean all four of these merchants, brought it to my attention, that their rent at that point was greater than ever expected or could afford to pay for it.

Well, I didn't do anything about it at that point. I felt [fol. 10375] that this might be a temporary thing.

And also I told them that there were months that they do quite well and when they didn't give me an increase, but considering now that their business was bad, why I should decrease it at that particular time?

Then we went through the thing without change until the end of December, and after the holidays at that year, at which point if I recall correctly we had another very bad time in their particular line of business and they approached me again, telling me that they had the two increases, and they said, "Why not give us a break for a couple of months in the winter," whereby they could have some semblance of a break on the rent.

Incidentally, your Honor, these people occupied frontage of no less than about 40 feet and they had a very perishable item, and as an example of it, with the produce tenants that is quite an item in the Market.

For example, if they were to bring up, say, 30 boxes of bananas which represents about 1200 pounds, and if they lost half of that load of bananas on a Saturday because they didn't sell them, they can't eat all of those bananas come [fol. 10376] Wednesday, and that is what they had or what they were up against, and this was quite a loss.

And then there was the situation where I was being besieged more or less, and where they were clamoring for other items which could be used as sale items, the expenditure of sums for advertising matters and the like being considered, because after all we did have the kind of Market that brings in people off the beaten path.

Then, of course, there arose another complaint, with the same kind of rent, they would say, with the same kind of rent we are paying to you, how can we afford to give the meat item at cost or less than cost?

But my argument was that if we could have a losing item with meat, that could very well be made up on the difference with the other items that they had on the stand.

Well, this policy I followed, but then later on we reduced the rent to $7 a foot, but at the same time they had to promise that they would give me these items that I was asking for.

The Court: And has it remained at $7 a foot since then? [fol. 10377] The Witness: No, because quite a change has come about since then, quite a change, your Honor.

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[fol. 10394] The Witness: Some time in August of 1957 I received a phone call from an alleged stockholder whose name is Eskander Manoochehrian, and he called me on other occasions because he happened to be the brother of my brother-in-law, and I thought that this was just one of those social calls until he said to me that he had a phone call from Mr. Melvin Robbins, and that Mr. Melvin Robbins was trying to buy his stock.

And I pleaded with him until December of that year not to sell it at all.

And the only reason that I purchased his stock at that time was so that these people who were trying to, as far as I was concerned, beat the corporation where they could to benefit their own particular case, I just felt that was a thing I had to do, your Honor, and I never dreamed that I was a fiduciary and it was not a proper thing for me to do.

The only reason I did not want to do it before was I did not have the money to do it.

So I started pleading with my brother-in-law not to do it, and then I had to borrow money at that time so I could purchase the stock and in that way prevent them from getting it.

[fol. 10395] And as far as my own opinion was concerned, and because of my conversations with them, I felt that they had only one motive in mind, and that was to get what they were looking for for their particular tenants or clients and the heck with everybody else.

I even felt that then at that time that they would throw merchants out of the Market who were selling products that might be sold by their people, even though the people in the Market might not be on written lease but oral lease, such as some of the tenants are. And it does seem a very unfair thing for them to try to bring about that condition, and I bought the stock to stop that kind of movement.

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[fol. 10462] Cross examination of James La Grotte.

By Mr. Fried:

Q. Mr. La Grotte, in early 1952 do you recall there was —and this is before I took the races over in August, 1952, you understand—

[fol. 10463] A. Yes—

Q. There was another promoter who had run the races there, is that right?

A. Yes.

Q. Do you remember his name?

A. Oh, I don't remember.

Q. See if I can try to help you with the name.

A. No, I can't remember his name.

Q. Do you remember a man by the name of Garry Gordon?

A. That is right, Garry Gordon.

Q. When Garry Gordon was running the races at the Nazareth Fair Grounds did you run the food concession on Sundays?

A. Yes, sir.

Q. And to whom did you pay the rent?

A. Garry Gordon.

Q. You did pay it only to Garry Gordon, is that right?

A. Yes.

Q. And when Garry Gordon left and we took over the races, Jerome Fried, myself and this other party, what is it I told you to do or to pay about the rent at that point?

[fol. 10464] A. You told me to pay the Nazareth Farmers Market.

Q. And did I tell you to do that?

A. Well, you explained to me that the Market needed the money.

Q. Yes.

A. And you told me to pay the rent to the Nazareth Farmers Market which I agreed to. I didn't have no objection to who I did pay the rent to.

Q. That is, I said to you that the Market needed the money?

A. That is right.

Q. And I told you to pay the rent to them?

A. That is right.

Q. Instead of to me?

A. That is right.

Q. Is that correct?

A. That is correct.

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[fol. 10482] [File endorsement omitted]

IN UNITED STATES DISTRICT COURT

Bankruptcy 89669

In the Matter

of

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.

Transcript of Hearing—June 14, 1960

New York, June 14, 1960,
10:30 A.M.

Before:

HON. SIDNEY SUGARMAN,
District Judge.

APPEARANCES:

Rosen & Rosen, Esqs., Attorneys for Debtor; Alex L. Rosen, Esq., of Counsel.

Charles Seligson, Esq., Examiner.

Melvin Lloyd Robbins, Esq., Attorney for Robert H. Davidson, Frederick Katzenell, Irving J. Wolf, Richard Hull, Ernest Pollak, Dorothy Kane, Ann Rosen and Wilson Rehrig.

Benjamin Margolis, Esq., Attorney for Benjamin Margolis, Ida May Margolis, Sarah Kason and Bernard L. Unger.

Jerome Fried, Esq., pro se and Aaron Fried.

Arnold A. Weinstein, pro se.

[fol. 10483]

COLLOQUY BETWEEN COURT AND COUNSEL

The Court: We will first address our attention to the application by Mr. Weinstein.

By order to show cause dated June 9, 1960, Arnold A. Weinstein moves for an order "Reopening the hearing heretofore had on the petition of Irving J. Wolf, verified March 13, 1959, for termination and recoupment of compensation (pursuant to Section 249 of the Bankruptcy Act) in respect of that branch of said petition dealing with termination of compensation payable to respondent Arnold A. Weinstein, so as to permit said respondent to offer and submit proof and testimony relating to and in support of the defenses interposed in his answer to the said petition, . . ."

For purposes of this motion, the Court will assume that the Weinstein stock purchase was made in good faith as he contends, i.e., under compulsion and in furtherance of what movant conceived to be the debtor's best interests. Nevertheless, the purchase of stock of a debtor by a fiduciary is absolutely prohibited.

Judge Dimock's language—footnote 1: In re Third Avenue Transit Corporation, 159 Fed. Supp. 440, 443-444 (SD NY 1958), affirmed sub. nom. Surface Transit, Inc., v. Saxe, Bacon & O'Shea, 266 Fed. 2d 862 (Second Circuit 1959)—[fol. 10484] in denying compensation to a fiduciary who was forced to sell bonds of a corporation in reorganization is especially apt here:

> "This result is nothing short of tragic . . . I am convinced that such was the claimant's interest in his work for his clients, as distinguished from his interest in his own compensation, that he was completely oblivious to the provisions of Section 249 at the time that he sold the bonds . . .
>
> "Nevertheless Congress, in its wisdom, has tied the hands of the courts. So strong is the public policy against dealings by persons engaged in the reorganization of a corporation in the securities of that corporation that the courts are not allowed to remunerate from the estate one of them who buys or sells any of those securities. No amount of benefit conferred upon the estate by a claimant can be permitted to make up for a single harmless false step taken innocently in a time of stress."

Now I realize that Judge Dimock was dealing with a strict Section 249 proceeding. I realize further that in reversing the referee here I held that strict construction of Section 249 was not to be applied, that it was the spirit [fol. 10485] rather than the letter of the section that applied, and that what was intended by Section 249 applied here even though the compensation might be different between that of an allowance subsequently made and that of compensation as an employee or officer of a corporation previously made. However, in any event, on the basis of the holdings cited, Mr. Weinstein's motion to adduce additional proof to try and justify what he did is denied.

Mr. Weinstein: If your Honor please, not in further argument in respect of that branch of the application, I realize that I am imposing on the Court in attempting at this time to amend the application upon which your Honor just ruled. I can only say that the thought came to me very, very recently. As a matter of fact, it was over the week-end. I am going to ask your Honor to permit me to amend the answer which I had interposed in connection with the application for termination and recoupment, also as far as the application for removal was concerned, on this ground: that the petitioner, Mr. Wolf, has waived his rights to proceed under Section 249 in this respect. As your Honor knows, an application is presently pending before your Honor—

[fol. 10486] The Court: Let me interrupt you. Where is the application under 249 for removal?

Mr. Weinstein: The application is not under 249 for removal.

The Court: Let us not confuse a bad record any more than we have to. I am dealing now with an application for termination of compensation and recoupment of compensation brought on by a verified petition dated March 13, 1959.

Mr. Weinstein: Yes, sir.

In that respect I suggested to your Honor a waiver on the part of Mr. Wolf, the petitioner here, in this respect: As your Honor well knows, an application has been pending before your Honor for the approval of an election which was held on August 1, 1958.

The Court: And that is one of the items that is before me this morning.

Mr. Weinstein: That is quite so. I am not, however, directing my remarks to the decision on that particular application except that I am bringing it to your Honor's attention. At that election which was held on August 1, 1958, Mr. Wolf, the petitioner here, voted in favor of my election as an officer and director of this corporation.

[fol. 10487] The Court: That has nothing to do with the application before us. Nobody is removing you as president. I have held that under the spirit of Section 249 that you are to receive no compensation.

Mr. Weinstein: I am directing my remarks, your Honor, specifically to that.

The Court: You are saying because he voted for you to be a president of the corporation or a director, and the directors in turn elected you president—in the first place, Mr. Wolf was not a director, was he?

Mr. Weinstein: No, sir, he was not.

The Court: The officers are elected by the directors, not by the stockholders.

Mr. Weinstein: That is quite true.

The Court: He voted for you as a director apparently.

Mr. Weinstein: Yes, sir.

The Court: He did not vote for you as president.

Mr. Weinstein: No.

The Court: I understand the thrust of your argument is by having voted for you as a director of the corporation he waived by some legal legerdemain that I do not under-

[fol. 10488] stand his right to bring on an application to end your compensation.

Mr. Weinstein: If your Honor permits me two more minutes, I will be able to explain it.

The Court: I won't allow you two more minutes because I think you are wasting my time. I made it clear that no matter how good your intentions were in the purchase of that stock that you violated the spirit of Section 249 and whole spirit of the Chapter X proscription against fiduciaries dealing in the stock of a debtor of which they are fiduciaries.

Mr. Weinstein: I appreciate your Honor's position. I merely wanted to say that the election at that time was

unanimous and the vote was taken and had at a time when knowledge was had by all of the parties with respect to the previous purchase of stock, and knowledge was also had—

The Court: I will assume that, Mr. Weinstein, and it does not alter my opinion about it. Nevertheless, I will deny your application. I will assume what you say to be so, that when they voted for you as a director and when the directors elected you president that they had full knowledge of your dealing in the stock. Whether they knew at that time that [fol. 10489] that would constitute a violation of the spirit of Chapter X I think is unimportant.

Once it was brought to the Court's attention, the Court had every right to act. Now the Court did act to the extent of directing that your compensation cease, but delayed the entry of an order, and the reason for that delay will be touched upon when I get to the remaining application for an order in the four pending matters still open before the Court.

Mr. Weinstein: Yes, sir.

The Court: By order dated May 31, 1960, the Court directed that Nazareth Fair Grounds & Farmers Market, Inc., the debtor, Arnold A. Weinstein, H. Lawrence Laupheimer and Jerome Fried show cause today, the 14th day of June, 1960, why the Court "Should not make a direct entry of an entry or orders, forthwith, granting the following petitions now pending before this Court, namely: (a) Petition, verified March 13, 1959, for termination and recoupment of compensation (pursuant to Section 249 of the Bankruptcy Act); (b) Petition, verified January 5, 1960, for removal of president, secretary-treasurer and general manager of debtor for misconduct in office, and for termination and recoupment of compensation; (c) Petition, verified [fol. 10490] January 6, 1960, for cancellation or rejection of (Enterprises) lease and for accounting by lessee; (d) Petition, verified August 6, 1958, for approval of proposed directors and officers of debtor (pursuant to Section 191 of the Bankruptcy Act); . . ."

Preliminarily, the record should reflect that earlier disposition of the matters was deferred by the Court in the

expectation that the decision of the issues of law and fact raised in the trial of the claims of putative holders of shares of stock of the debtor would dispose of certain branches of the petitions previously mentioned.

However, the pressure of other court business and the time required to be spent reviewing the thousands of pages of testimony and the hundreds of exhibits received on the trial of the stock claims will preclude decision of those claims for several months.

The nature of the matters before the Court anew today, dealing with debtor's management, should not be left undecided any longer.

The petitioner was directed to submit an order to show cause so that the parties might be given notice of the Court's intention to take appropriate action on the petitions at this time.

[fol. 10491] Accordingly, unless any respondent desires to be heard, the Court will now rule on the instant motion brought on by order to show cause. The Court does not invite reargument of the petitions. It does not ask for new evidence. It simply asks for legal cause why the matters should not now be ruled on.

Does any respondent wish to be heard?

Mr. Fried: Your Honor, I realize that when you ruled for termination of my pay on January 4th—I believe that was the date—that at that point I had no opportunity to explain to the Court what my job was, so perhaps I could not be classified as a fiduciary if the Court knew. At this point I still have not had that type of opportunity.

The Court: Do you wish to take the stand and offer proof?

Mr. Fried: Yes.

The Court: Go ahead.

[fol. 10492] JEROME FRIED, called as a witness, having been first duly sworn by the Clerk of the court, testified as follows:

Direct examination.

By Mr. Fried:

The Witness: I would like to explain to the Court my job for which I am paid a weekly salary at the Nazareth Fair Grounds & Farmers Market.

In explaining my work at the Market I would like first to say that one of the biggest parts of the work involved is that of the promotion for the general merchants at the Nazareth Farmers Market, for which the Market is greatly responsible both for the making up of the advertising and the production of the entire advertising campaign and over the years this job has become primary.

In the past, aside from advertising, there has been a matter of collection of rents. Before and even during the proceedings of this Chapter X we used to hire a man who would collect rents from those tenants who did not send their checks in through the mail or deliver them to the office. His name was Maynard Huber.

We reached a point at the Market where money was quite tight and so it seemed more feasible in order to save some [fol. 10493] money that I begin to collect rents which had to be collected by someone, and we saved the pay that this Maynard Huber was then getting. At no time since I have been working for the Market have I done just anything that is strictly on my own in the form of what might be considered a fiduciary. I have always conferred with the president of the corporation in matters of leases with tenants, which is our big business, that is what we do, we rent space, and in every case Mr. Weinstein has been first asked whether or not these particular deals with tenants were proper.

The Court: Mr. Fried, how often is Mr. Weinstein at the Market?

The Witness: At least once a week.

The Court: In the interim, when he is not at the Market,

who operates the business and manages the property of the debtor?

The Witness: I do, sir.

The Court: Go ahead.

The Witness: In the interim I would also like to add if we were to check our phone bills between Nazareth and New York, Mr. Weinstein's office, it would be obvious I talk a great deal with Mr. Weinstein on the phone other than his visits to the Market. In some instances, even my [fol. 10494] own suggestions were not acceptable to Mr. Weinstein, and so they did not occur.

By and large, I might add, your Honor, that this is just my own opinion, that I do not know whether the intent of Congress in drawing Section 249 was to penalize a man working for a firm not in any official capacity such as an officer or director who makes policy, and certainly I have never had any position where I had any particular or any more knowledge than anyone else in the entire corporation and in our entire area where the stock claims were public record. I had no particular knowledge as to whose stock might or might not be good and I am sure nobody has had that knowledge.

The Court: Mr. Fried, notwithstanding your protestations that you were a mere employee, who was it that arranged for the paving contract?

The Witness: I arranged for it.

The Court: Who arranged for the carting loan?

The Witness: May I go back to the paving job?

The Court: Yes.

The Witness: Firstly, we got figures from various people.

The Court: Who is "we"?

The Witness: I got the figures. Somebody had to do it. [fol. 10495] The Court: That is precisely the point.

The Witness: And these figures were submitted.

The Court: To whom?

The Witness: To Mr. Weinstein, who submitted them to Professor Seligson, who signed the order, who approved the paving job. I cannot see where I had anything to do with the approval of the paving job. Then the Court finally did not approve it anyway. But we had gone ahead

with the job on the basis that Professor Seligson said it was all right to do it at the time, so I did not do the job myself.

On none of these things, your Honor, in the question of building the building, and so on, it was always a matter of somebody had to get the figures together and it happened to be that I was there, and I don't think I should be punished as a fiduciary.

The Court: You are not being punished.

The Witness: If my pay is stopped, I would be. I feel, in any event, inasmuch as I had previously owned stock in this corporation as a stockholder, before I ever made any purchases, the only difference that I could see in the fact that I purchased the stock was the fact that the stock was [fol. 10496] transferred from one person to another. It did not give me anything additional. For example, your Honor—

The Court: I am not going to hear any argument on that. You are in the same boat as Mr. Weinstein on that, no matter how good your intentions were for the benefit of the debtor, this purchase may have in your mind been proper, and I don't challenge that at all, you are in the same position as Mr. Weinstein.

The law forbids it, you should not have done it and you cannot get compensation if you did.

The Witness: What I am saying—

The Court: The only difference between you and Mr. Weinstein is that you claim you were a mere menial employee and not a fiduciary, but from my knowledge of this proceeding over the past number of years, my visit to the Market, and so on, you were substantially more than a mere employee. You were no cop in the parking lot. You ran the business while Mr. Weinstein wasn't there. As you admitted, you operated the business and managed the property of the debtor. The fact that you consulted and got approval from the directors does not diminish your status in the structure of the debtor. You were the managing agent.

The Witness: I only wish I had known that before.

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[fol. 10497] Cross examination.

By Mr. Rosen:

Q. Mr. Fried, were you authorized to sign checks?

A. No, sir.

Q. Were you authorized to sign contracts?

A. No, sir.

Q. Were you authorized to sign anything tying the debtor in any manner?

A. No, sir.

Q. The debtor operates a market?

A. Right.

Q. Where it does leasing?

A. Correct.

Q. Let me see if I can define your duties in the market and if I am incorrect kindly correct me. In the operations of this debtor in leasing the market, if somebody comes to the market and wants space, you talk to him?

[fol. 10498] A. Right.

Q. Beyond that, anything you take up as far as signing the lease or confirming anything you have to take that up with Mr. Weinstein?

A. I try to work out the rental as we know it should be in the Market, that is, the price that we have generally. Then I submit the figures to Mr. Weinstein and I ask him does he think this will work out for this particular tenant, because the figures vary.

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[fol. 10500] Q. Might I ask kindly whether your duties were discussing complaints with tenants, collecting the rent, [fol. 10501] discussing the leasing with them, seeing that the employees attended to their job, and beyond that, where any discretion was to be used or any documents were to be signed on behalf of the debtor, contracts, leases, et cetera, you would have to go to the office of Mr. Weinstein?

A. That's correct.

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[fol. 10502] The Witness: Your Honor, I brought up the matter of advertising especially, because that certainly does

not come under any category of a fiduciary. Formulating advertising matter and the promotion, on every Market day we have it is a matter of discussing prices and items with I wouldn't say many, but with 20 or so different merchants who have different ideas. That takes a great deal of work, jelling that, and I don't see that that makes me a fiduciary.

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[fol. 10511] Cross examination.

By Mr. Weinstein:

Q. As part of your duties, it is your job to see that the Market is clean and the aisles are swept, garbage removed and matters of that nature, is that correct?

A. I don't do it myself, but I see to it that it gets done.

Q. It is your job to superintendent the people who clean and keep the place in clean condition?

A. Yes, and see that they have the materials to do it with.

Q. That encompasses the ordering of cleaning supplies, brooms and sweepers?

A. Everything that we need for cleaning.

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[fol. 10519] Cross examination.

By Mr. Seligson:

Q. Did you at any time tell Mr. Weinstein you thought you should get more money because of the services you were rendering?

A. Yes.

Q. When the petition was filed, you first got $100 a week?

[fol. 10520] A. I guess it was that amount.

Q. You were then designated as general manager?

A. Somebody designated me as general manager.

Q. You knew you were?

A. I knew I was working.

Q. Did you know that you had been designated as general manager?

A. I don't think I knew anything that I was being called.

Q. You are on the witness stand. Did you or did you not know?

A. My best recollection is that I was always general manager of the Market.

Q. Did you know that the order of this court provided for your continuance as general manager of the debtor?

A. I wouldn't be on the job if I weren't continued.

Q. Did you know the order so provided?

A. I don't remember seeing the order at that time. I was told I was going to stay on the job.

Q. Were you told that you were the general manager of the business and would run it?

[fol. 10521] A. Nobody ever said anything like that to me.

Q. Did you ever see the order?

A. Not during those days. I have seen it since.

Q. When did you first see it?

A. I don't remember that.

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Q. Thereafter you went or did you go to Mr. Weinstein and tell him that you thought your salary ought to be increased?

A. Sometimes after that, yes.

Q. Did you tell him that you thought your salary ought to be increased because of the increased responsibility that had been given to you?

A. No, I don't think that at all.

Q. What did you tell him?

A. I told him I was working too hard for the money I was getting.

Q. And he agreed to an increase and he applied to the court for an increase to $150 a week?

A. As I recall, Professor, it did not work out quite like that.

[fol. 10522] Q. How did it work out?

A. I was asked to cut my salary back when they filed the proceedings. I was told at the time it would not take

more than 90 days. For 90 days I did not feel I would argue for a difference of a hundred dollars.

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Q. Did you thereafter ask Mr. Weinstein to get your salary increased to $200 a week?

A. I certainly did.

[fol. 10523] Q. What did you tell him?

A. I told him I was to have more pay for the work I was doing, the work was mounting up, getting rough.

Q. He then went to the Court and he got an order on January 13, 1956, increasing your salary to $200 per week?

A. Yes.

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Q. Did you ever sign any checks for the debtor?

A. I can't.

Q. Did you ever?

A. No.

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[fol. 10525] Q. But subsequent to the Chapter X you were not a director and officer?

A. No, sir.

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RULINGS BY THE COURT AND COLLOQUY THEREON:

The Court: I am considering the testimony of Mr. Fried as an application for reconsideration, as I did the application of Mr. Weinstein, of my memorandum of January 4, 1960, where in the third paragraph I said, "The records thus far establishes that Weinstein and Fried are such salaried employees who are fiduciaries and have traded in the debtor's stock."

Now, while Mr. Weinstein's application for reconsideration dealt with the justification for trading in the debtor's stock, Mr. Fried's application I would assume deals not only [fol. 10526] with that but also with the determination that he was a fiduciary.

Nothwithstanding this additional proof, I am disposed to deny any reconsideration and adhere to the decision of January 4th.

There is no problem, I might observe parenthetically, as to the timeliness of these applications, because the memorandum is not the Court's final order. So both applications in my view are within the time.

However, on the merits, the decision of January 4, 1960, is adhered to.

Keeping in mind that the present blanket application, so to speak, seeks orders in four separate pending matters, and I review them again, the first for a termination and recoupment of compensation pursuant to Section 249, the second for the removal of the officers and for termination and recoupment of compensation, the third for the cancellation or rejection of the lease to Enterprises and an accounting by the lessee, and the fourth for the approval of the election of directors and officers. Omitting for the moment the third, which deals with the cancellation and rejection of the Enterprises lease and concerning ourselves only with the first, second and fourth, does anyone wish to state [fol. 10527] any legal cause why those matters should not now be ruled upon?

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[fol. 10529] The Court: I am acquainted with the fact that the debtor has made money, but my feeling is that these people dealt with the stock, technical or otherwise, and I share Judge Dimock's regret at the result. However, Congress has made a pronouncement, and it has to be adhered to. In the light of the fact that I cannot dispose of these stock claims in the Margolis review, I intend to spend the entire summer on it. I have already spent some time when not engaged in other matters, nights and weekends, reading the 200-odd page recommendation of the examiner, but I am not content to rely, notwithstanding my great respect and admiration for Professor Seligson, I am not content to rely on his appraisal in and of itself. I have got to review the entire record myself.

I cannot permit the condition to persist where I have said that these men have violated the spirit of Chapter X and yet permitted them to draw compensation and operate and manage the debtor's affairs.

Mr. Rosen: It is seven years. Would 90 days make much difference? If your Honor feels there is bad faith, or if

[fol. 10530] your Honor feels there has been some immorality, then that is different.

The Court: Bad faith and immorality do not enter into it, Mr. Rosen.

Mr. Rosen: Then I say if that is the situation, isn't the most important thing for the creditors, for the stockholders, for everybody concerned the best interest of the debtor?

The Court: From your point of view it may be. But from my point of view the important thing is what has Congress said, and I have ignored that ever since January in the hope that this matter could be resolved within 60 or 90 days. Now I realize it cannot be. I am not disposed to flout a congressional fiat any longer.

Mr. Rosen: Who would benefit by this? I think the most important thing is the debtor itself, the harm and the prejudice to the debtor. Congress also has said that your Honor should protect the interests of the stockholders and the interests of the creditors and to conserve the assets of this estate so there should be no harm done. That is another mandate from the Congress.

The Court: That's right, but Congress has categorically stated that those who are fiduciaries should not trade in [fol. 10531] the stock. It made the act the test, not good faith.

Mr. Rosen: But you have a right to weigh both things on a scale, the interest of the debtor and the interest of the creditors and the other. Can't your Honor use your equity powers at the moment and hold this thing until we really get to the merits?

The Court: I feel that I have it long enough.

Addressing yourselves anew to the three phases of this motion, exclusive of the one dealing with the Enterprises lease, does anyone else wish to be heard?

Mr. Rosen: Might I ask one thing, your Honor. There has been in the paper submitted by Mr. Robbins some statements, as usual, where purportedly there has been preferences, where his client has been damaged and hurt.

The Court: I am not interested in that.

Mr. Rosen: I wanted to bring that out.

The Court: I thought I made very clear the basis for my bringing this matter on, and that was the Court's alarm

at the fact that after having held these men disqualified for a purely technical statutory reason the Court sat on its [fol. 10532] hands in the hope that it might be able to resolve this whole problem. Realizing that much time will go by before the whole problem is resolved, the Court felt that it could no longer in good conscience permit this condition to continue. I am not interested in how much space Rehrig gets in advertising or the fact that he does not like Fried or Fried does not like him. That does not bother me in the least. What I am interested in is having made a pronouncement I have done nothing since January to put that pronouncement into effect, and for the reason heretofore explained, that I thought the whole matter could be resolved. I realize it cannot be resolved within a reasonable time.

Finally, I ask if anyone wishes to be heard further on (a), (b) or (d) of the present moment?

No one indicating a desire to be heard, I will continue.

Taking the matters seriatim, as set forth in the order to show cause, the branch of the petition designated (a) for termination of compensation pursuant to Section 249 has already been granted by memorandum decision dated January 4, 1960.

To the extent that the branch of the petition designated (a) seeks restitution and recoupment of past compensation [fol. 10533] and past reimbursement of expenses it is denied.

The next proceeding to dispose of is the branch of the petition designated (b) which asks (1) for removal of the president and general manager of the debtor for misconduct in office, (2) for termination of compensation and reimbursement of expenses and (3) for recoupment of compensation and reimbursed expenses.

The second branch of this application is academic in view of the disposition of the petition bottomed on the violation of Section 249 and hence is denied as moot.

The third subdivision of the second branch of the petition is denied, i.e., for recoupment of compensation and reimbursed expenses.

As to the first branch of the petition (which has been abandoned as to respondent Laupheimer), there is no au-

thority for the Court to order directly the removal of an officer or agent of the debtor. However, in view of the Court's disposition of the petition for termination of compensation to Messrs. Weinstein and Fried, they can no longer function in their respective offices of president and general manager of the debtor.

Section 188 of the Bankruptcy Act provides:

[fol. 10534] "A debtor continued in possession of its property shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe."

Section 189 of the Bankruptcy Act allows a trustee or debtor in possession to "operate the business and manage the property of the debtor" under judicial authorization.

The following are now made terms and conditions of the continuation of the debtor in possession and the operation by it of the business and management of the property of the debtor:

(a) Jerome Fried will be discharged from the debtor's employ at once.

(b) Arnold A. Weinstein, president of the debtor, shall have nothing further to do with the operation of its business and affairs, and management of its property.

(c) No funds of the debtor shall be disbursed except on the countersignature of Martin H. Philip, as treasurer, [fol. 10535] whose election is hereinafter confirmed.

(d) Pending the approval by the Court of the employment of a general manager of the debtor, Martin H. Philip shall supervise its affairs.

I see that Mr. Philip is in the courtroom. Do you undertake to do so, sir?

Mr. Philip: I do, your Honor.

The Court: Parenthetically, I want all persons interested who choose to place nominations for general manager to

have those nominations in the hands of the examiner within 48 hours. I am asking the examiner to immediately interview those nominees and then to set up a schedule of interviews with the Court so that a general manager can be appointed to take over as quickly as possible.

The third matter, i.e., the petition for cancellation or rejection of Enterprises' lease designated as subdivision (c) and for an accounting will be heard at 10:30 A.M. on September 26, 1960, in room 1506. Please check the room number, because the Clerk may assign a different room for that day.

As of the present time, that is the room I am assigned to.

Finally, the petition for approval of the election of offi- [fol. 10536] cers and directors of the debtor designated as subdivision (d) is granted.

It is so ordered. No further order is necessary.

Mr. Rosen: Your Honor, if I understand that last portion, as I understand the election of directors, they were Mr. Weinstein, Mr. Laupheimer and Mr. Philip—

The Court: And then Mr. Weinstein was elected president, Mr. Philip was elected treasurer and Mr. Laupheimer was elected vice-president. There were three—how many directors were elected?

Mr. Rosen: Three directors.

The Court: And they were Messrs. Weinstein, Danciger and Philip. The directors then met and they elected officers. They elected Mr. Weinstein as president. They elected Mr. Philip as treasurer. Then they elected Mr. Danciger as what?

Mr. Weinstein: Secretary, I believe. Mr. Laupheimer, who was not a director, was elected vice-president.

Mr. Rosen: I am merely trying to understand your Honor's ruling or the effect of it.

The Court: The effect of my ruling is this: that although [fol. 10537] Mr. Weinstein was elected president, and although I am now confirming his election of president because of the fact as I have stated that I have no power to remove him, I nevertheless, because of his trading in the stock, direct that he have no part in the operation of the debtor or the management of its property.

That raises the question: who succeeds to his powers? That is, if it becomes important. The by-laws of the debtor, so far as I can ascertain, do not specifically provide that the vice-president automatically succeeds to the powers of the president in the event of a vacancy or disability of any kind. If any question arises as to powers here, the parties will have to come before the Court again. I do not wish to anticipate.

However, in the interim, I am providing as to the fiscal affairs of the company, Mr. Philip, the treasurer, will undertake, at least in so far as the signing of checks is concerned, the functions of the treasurer, and that the parties immediately consult with the examiner for the purpose of our employing a new managing agent.

Mr. Rosen: So that technically the officers stand as is, [fol. 10538] and I as attorney for the debtor, if I have to have any petitions signed, I still come to an officer for the signing of a petition, but as far as the physical operations of the business itself, that has been designated to Mr. Philip.

The Court: I cannot see how Mr. Weinstein can adhere to the Court's direction that he have nothing to do with management and operation and still sign petitions, if that is what you have in mind.

Mr. Rosen: Whom am I as attorney for the debtor to apply to?

The Court: You have a vice-president, a secretary and a treasurer who are not under the disability that Mr. Weinstein is under. If I had the power, I would remove from Mr. Weinstein as president because he traded in the stock. But I don't have that power. I only have the power to tell the debtor in possession how it shall manage the affairs and operate the property of the debtor. What I am saying now is because and solely because of Mr. Weinstein's trading in the stock he can have no hand in management and operation.

I had hoped to avoid that by having a disposition of the entire matter before this time. But I can see now that that [fol. 10539] is impossible, and I cannot remain silent any longer.

Mr. Seligson: Mr. Rosen is not affected in any way.

The Court: Of course not. Mr. Rosen remains counsel for the debtor. The only thing is he won't be able to deal with Mr. Weinstein as he has done properly heretofore.

Mr. Seligson: The board of directors can meet and authorize the vice-president to take action on behalf of the corporation—or the treasurer.

Mr. Robbins: I would like to ask the Court for clarification. Number 1, I believe the Court stated that the removal petition had been withdrawn with respect to Mr. Laupheimer.

The Court: I so understood.

Mr. Robbins: Your Honor, that probably is my fault, but my understanding was that it was the first petition under Section 249 that was withdrawn and not the second on removal. For those purposes, your Honor might care—

The Court: In the first place, I have ruled that I have no power to remove any officer.

Mr. Robbins: I am only trying to get the record [fol. 10540] straight.

The Court: With respect to Section 249, they overlap. I understood that subdivision (b) of your present show cause order was intended to cover the possibility that was engendered by the referee's decision that Section 249 did not apply to this situation, to try and bring it within the general equity powers of the Court. I have no power to remove any officer. I have power to determine compensation. I have now determined as of this day that there will be no compensation paid to Mr. Fried and to Mr. Weinstein.

I have now determined that despite the fact that there will be no compensation in the future for good and sufficient equitable reasons they will not be compelled to reimburse either compensation or expenses.

Mr. Robbins: May I ask one more thing, your Honor?

The Court: Yes.

Mr. Robbins: There has been no ruling, no finding made and no specific conclusions as to some of the other charges made under the removal petition with respect to the re-

duction of rents paid by Enterprises and with respect to the Sunday rents.

The Court: I won't make any such findings until I go [fol. 10541] into the question of the Enterprises' lease.

Mr. Robbins: May I ask whether the denial of petitioners with respect to recoupment and compensation are in any way based on findings with respect to the rents at the Market?

The Court: I don't understand your question.

Mr. Robbins: The removal petition in particular alleges certain facts with respect to the Enterprises' rents paid to the Market and with respect to the Lagrotte rents which were allegedly diverted from the Market to Enterprises.

The Court: Mr. Robbins, I thought I made my position clear; that regardless of the justification therefor I have no power to remove the officers of the debtor.

Mr. Robbins: I am addressing myself to the recoupment aspect. There has been a decision on the recoupment where the underlying petition deals also with this rent situation, and to that extent I am just trying to ascertain whether the recoupment aspect involves in any way a denial of the petition—let me amend that—whether your Honor's decision on the recoupment in a sense sub silencio determines that there was no diversion of rents and there was no im-[fol. 10542] proper failure to pay the proper rents?

The Court: Where is the distinction at least so far as Enterprises is concerned between what you are talking about and subdivision (c) which calls for an accounting by the lessee?

Mr. Robbins: The facts are the same, that is quite true, but what I am trying to understand is this: Your Honor has denied clearly the petition for recoupment under both Section 249 and the removal petition, and in denying the recoupment presumably your Honor is saying—

The Court: The sub silencio aspect will be immediately eliminated from the record. Under no circumstances am I of the disposition to require either Fried or Weinstein to give the debtor back anything. What that leaves open in so far as Enterprises is concerned is an accounting by the lessee. That will be heard on September 26th. But so far

as Fried's sharing in the profits of the food company, J & J, I believe it is, I have no intention and I have a definite intention not to direct him to make any such recoupment of that compensation or expenses. However, that is not to be understood to say that on September 26th or thereafter, when we resolve the question of the Enterprises' lease, he [fol. 10543] may not, if he is found to have unfairly dealt with the debtor, be required to make an accounting under that lease.

Does that answer your question?

Mr. Robbins: Your Honor, I think it answers my question. I think I understand, thank you, sir.

The Court: I make provision that this decision shall constitute the Court's findings and conclusions. The parties are relegated to the rule that if anyone wants additional findings and conclusions they may be submitted on notice.

Mr. Rosen: May I kindly ask for an opportunity to submit a cross-order on the original order that was submitted by Mr. Robbins?

The Court: I am not signing Mr. Robbins' original order. I am making my decision today under an order of the Court, with the right of any party to submit a long form order if they choose. Under the general practice in the court, if anybody submits a long form order, anybody else has the right to submit a cross-order.

Mr. Rosen: Would your Honor consider a stay in the orders that are being submitted?

The Court: Denied. Get your stay in the Court of Ap- [fol. 10544] peals, if you want to take it up.

Mr. Rosen: There was one remark by Professor Seligson that the board of directors would have to meet. Let us say I have to draw something, a simple lease, will I have to call the board of directors?

The Court: Mr. Rosen, you are counsel for the debtor, not the examiner. The examiner gratuitously attempted to answer your question, but the resolution of what the legal requirements are is your obligation.

Mr. Rosen: Thank you, your Honor.

Mr. Fried: Your Honor, on the question of removal. Was that based on Section 249?

The Court: You are not being removed as anything.

Mr. Fried: You are removing me as general manager.

The Court: I am just terminating your employment. You are not an officer of the corporation, although you are a fiduciary. I say I don't have the power to remove Mr. Weinstein. I do say I have the power to direct the debtor that neither you nor he have anything to do with the management and operation of the debtor's affairs from this moment on.

[fol. 10545] Mr. Fried: I understand that.

The Court: I can't remove Mr. Weinstein as president. But I automatically removed you as general manager when I provided you can have nothing further to do with the management. You are finished.

Mr. Fried: I understand that. Just for information, was it based on Section 249?

The Court: Yes, it was based on the fact that you as a fiduciary improperly dealt in the stock of the company.

As Mr. Robbins pointed out, he made a motion that you be compelled to return to the debtor certain moneys obtained by you or your corporation Enterprises by virtue of the track lease and moneys obtained by you by virtue of your interest in some manner in the J & J lease. I have indicated that I will not compel you to return any salary, any expenses or any profits made by you by virtue of the J & J matter. However, I have provided for an accounting by Enterprises when I ultimately hear the question of cancellation or action on the present lease for the track. That remains open. Do you understand that?

Mr. Fried: I understand that part of it, your Honor. Was the ground that I have nothing to do with the Market [fol. 10546] based on the fact that I purchased the stock?

The Court: Yes.

Mr. Fried: It was just a matter of curiosity. So I made a mistake in purchasing stock. The idea of working for the Market and staying on the job has nothing to do with my pay.

The Court: I won't permit anybody to work for the Market without compensation. That would be a very curious

and doubtful situation. I will have no part of it, if that is what you are suggesting.

Mr. Fried: The merchants at the Market at one time submitted—

The Court: I refuse to entertain any idea that will permit you to have anything to do with the debtor, because you dealt in the debtor's securities and Congress said you cannot be compensated if you deal in the debtor's securities. Also I say that I will have nobody working in that Market without compensation or having his compensation paid by somebody else. That is a unique situation. I will have no part of it.

Mr. Fried: I feel a lot better now.

Mr. Weinstein: Your Honor has directed that I have [fol. 10547] nothing to do with the physical operation of the Market.

The Court: I have used the language of the statute, I have not limited it to operate. You shall have nothing to do with operating the business and managing the property of the debtor. That is in Section 189.

Mr. Weinstein: Just to make the matter quite specific in my own mind, because I don't want to go over the line that your Honor has drawn, your Honor has indicated that the directors and officers have not been removed. Would I be in contempt of your Honor if I participated in a meeting of the board of directors? I certainly do not wish to be in that position.

The Court: I hate to be put in the position of an advocate. I would suggest you discuss that with counsel for the debtor. He ultimately will be paid for his services to the debtor and I think the Court's order is quite clear. I made it clear that if I had the power I would have removed you as president because you trade in the stock, but I don't have the power. However, I do have power to say who shall manage the debtor's affairs. Because you trade in the stock, you are not one of those people. If in the light [fol. 10548] of that the counsel for the debtor undertakes to let you participate in the affairs of the debtor, that is up to him. If anybody moves for your punishment for con-

tempt, I will have to cross that bridge when we come to it. I am not an advocate here.

Mr. Weinstein: After all this, I certainly do not want to cross any further lines.

The Court: Is there anything else?

Mr. Weinstein: Inasmuch as there has been a fairly lengthy statement of your Honor's views here, may I respectfully request that a copy of your Honor's decision be transcribed and a copy of that delivered to the attorney for the debtor at the debtor's expense.

The Court: Don't we have a standing order for this entire record, Mr. Rosen?

Mr. Rosen: Yes, your Honor.

The Court: As a matter of fact, Mr. Rosen on one or two occasions brought to the Court's attention the tremendous expense of the records in this case.

Mr. Rosen: If your Honor has stated his ruling now, the minutes probably will take some time and then orders are to be submitted, am I to understand that as of this very moment their salaries cease?

[fol. 10549] The Court: Yes, not only their salaries cease, but their connection with the corporation ceases.

Mr. Rosen: If a long form order was served--

The Court: The time for appeal starts running as of today.

Mr. Seligson: In order to avoid any misunderstanding and any hitches in the continued operation of the business, you designated Mr. Philip as the one who should take over. May I suggest that you sign some short form order so that money can be withdrawn, so that expenses can be paid.

The Court: Why can't the directors adopt the usual resolution in line with the Court's direction.

Mr. Seligson: If Mr. Rosen is instructed to get the directors together—

The Court: Mr. Rosen as counsel for the debtor will do everything, I am sure, that is necessary under the Court's order to keep the debtor operating.

Mr. Rosen: I will try.

The Court: I don't think any order is necessary. In any event, the bank would require a resolution, which I believe

is common practice. I don't recall having signed any order in connection with the bank accounts of the debtor.

* * * * * * *

[fol. 10551] The Court: If there is nothing further to come before the Court, we are adjourned until September 26, 1960, at 10:30 A.M.

* * * * * * *

Reporter's Certificate to foregoing transcript (omitted in printing).

[fol. 10552]

SAUL, GENERAL'S EXAMINER'S EXHIBIT BC

Extract from Concession Agreement dated January 29, 1952 between Nazareth Fair Grounds & Farmers' Market, Inc. and James LaGrotte

1. Lessor gives and grants, at any and all events, to Concessionaire the right and privilege to prepare, dispense and sell food, drinks and beverages for consumption on the Fairgrounds premises during market nights, excepting only therefrom the right to prepare and sell popcorn on the premises. It is specifically understood and agreed that this concession agreement shall be limited to the Wednesday and Saturday nights (Market Nights) and shall not include any Fair operation nor any Race Track or other promotional items held at other times on the premises, unless some definite agreement as to that type of operation shall first be agreed upon by the parties hereto.

* * * * * * *

[fol. 10553] 3. Concessionaire covenants and agrees to pay to the lessor as percentage rental fifteen (15%) percent of any and all gross income received by the concessionaire from the operation of the concession space constituting the subject matter of the contract. * * *

4. It is agreed that the term gross sales in this Agreement shall be deemed to mean all receipts from the conduct of business by the concessionaire on the demised premises and all transactions had therein, including, but without being limited to, the gross sales of merchandise, whether sold for cash or on a charge basis, collected or uncollected, and all charges made for the rendition of services of any kind whatsoever.

* * * * * * *

9. Concessionaire and lessor agree that the term of this agreement shall commence with the date of its signing and shall continue for a term of three (3) years thereafter, which term shall be automatically renewed on a monthly basis, unless lessor shall notify concessionaire of a contrary

intention at least six months before the termination of this agreement and it is hereby agreed that either party may determine this lease agreement at the end of said term by giving to the other party written notice of at least six months prior thereto, but in default of such notice, this lease agreement shall continue upon the same terms and conditions and covenants as are herein contained for a period of one month and so on from month to month unless or until terminated by either party hereto giving the other at least six months written notice of such termination. The lessor, notwithstanding the provisions of this paragraph or any of the other provisions of the lease agreement, may at any time after the first year of the term of this lease agreement, cancel this lease agreement by giving at least sixty days written notice to the concessionaire.

[fol. 10554] 10. Concessionaire covenants and agrees that it will do none of the following things without the written consent of the lessor first had and obtained.

* * * * * * *

(b) Assign this lease or underlet or sublet the demised premises or any part thereof, or permit any other person, corporation to occupy the demised premises or any part thereof. * * *

* * * * * * *

15. It is expressly understood and agreed by and between the parties hereto that this lease sets forth all the promises, agreements, conditions and understandings between lessor and concessionaire relative to the demised premises, and that there are no promises, agreements, conditions or understandings, either oral or written between them other than are herein set forth. It is further understood and agreed that, except as herein otherwise provided, no subsequent alteration, amendment, change or addition to this lease shall be binding upon lessor or concessionaire unless reduced to writing and signed by them.

Saul, General: Examiner's Exhibit (Ledger Sheet - Zoloth and Soble)

		M Soble Capital	J Malakoff Capital	M Zolath Capital	M. Soble Loan	M. Zolath Loan	Capital
1	ORIGINAL INVESTMENT	40000 -					
2	4/7/51		12489				
3	8/7/51	38500 -		1500	37000		
	5/8/51 CASH RECEIVED		5000				
4	8/7/51		17489				
			J MALAKOFF LOAN				
	8/7/51		17489				
	8/7/51 LOSS FOR PERIOD	67654		67654			
5	BALANCE OF PARTNERSHIP 8/7/51	82356	17489	82356	37000		
5	OPENING OF CORP. 8/7/51		17489		37073 46	736	1500
6	JAN 52		9507 ✓716				
	CLOSING 6/30/52						
7	J. ENTRY #17	6800					
8	#13		37146 92		37073 46	736	-
9	#14		8750 -				
10	RECLASSIFICATION ENTRY #3		2000 - ✓ 7949 47				
	CORP. BALANCE 7/1/52		68092 92				1500
11	4/5/53 JE		350 -				
			68429 92				

J MALAKOFF LOAN
17489
8/7/51 LOSS FOR PERIOD 67654 67654
5 BALANCE OF PARTNERSHIP 8/7/51 82356 17489 82356 37000
5 OPENING OF CORP. 8/7/51 17489 37073 46 736 1500
6 JAN 52 9507 ✓716
CLOSING 6/30/52
7 J. ENTRY #17 6800
8 #13 37146 92 37073 46 736 -
9 #14 8750 -
10 RECLASSIFICATION ENTRY #3 2000 - ✓ 7949 47
CORP. BALANCE 7/1/52 68092 92 1500
11 4/5/53 JE 350 -
68429 92

opening Entry 4/17/51 to record
Sold Selg Scotia Coal
Insurance
Jacket
nty Dr
1st nty
2nd nty
loan n/c
loan M R
M Soble

opening Entry 4/17/51 General Journal to record purchase of bus
Sold Selg Scotia Coal 46000
Insurance 45630 4578 3969
Jacket 4545
nty Dr ✓6350
1st nty 8500
2nd nty 10000
loan n/cwy 5000
loan M R ✓7949 47
M Soble Cap 40000

[fol. 10556]

Saul, General: Examiner's Exhibit BY

GILBERT SUNSHINE
CERTIFIED PUBLIC ACCOUNTANT
466 Central Avenue Jersey City, New Jersey
Journal Square 4-5555

Charles Seligson, Esq.
350 Fifth Avenue
New York 1, New York

Dear Mr. Seligson:

In accordance with the order of the Honorable Sidney Sugerman, United States District Judge, Southern District of New York in the matter of Nazareth Fairgrounds and Farmers Market, Inc., Debtor (hereinafter referred to as Debtor) in proceedings for the Reorganization of a Corporation no. 89669, dated October 3, 1956, appointing you as Examiner, I have compiled, at your request, from the available books and records of the Debtor, and present herewith, Exhibits reflecting the financial position of the Debtor and the results of its operations from its inception to June 30, 1956.

Inasmuch as the Court has not yet adjudicated the many claims now pending, including the unpaid indebtedness prior to these Chapter X proceedings, these figures are subject to further adjustment. It must be borne in mind that all the expenses of administration have not yet been determined; in addition to those already reflected herein, there are undeterminable amounts applicable to the periods under review. No reserve for Federal or State taxes have been provided since the value of the claims allowable is incalculable at present.

The Exhibits and Schedules contained herein have been prepared from the available books and records of the Debtor, without audit. The notes and comments that follow are integral parts of these Exhibits and Schedules. Final reconstruction of the records of the Debtor may produce modifications hereof.

In viewing the Pro Forma Exhibits, it must be understood that they will all be revised by the allowable claims, before final statements can be prepared.

Respectfully submitted,

Gilbert Sunshine

GILBERT SUNSHINE

October 15, 1956
Jersey City, N. J.

Matter of Nazareth Fair Grounds & Farmers' Market, Inc., Debtor
C.A.2 Docket No. 27000 (Reorganization--S.D.N.Y. No. 889669)
General: Examiner's Exhibit BY

[fol. 10557]

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Index to Exhibits and Schedules

Exhibit

A	Purchase of fairgrounds by Morris Soble.
B-1	Balance Sheet, August 7, 1951 Last Date of Partnership.
B-2	Balance Sheet, August 8, 1951 First Date of Corporation.
C	Balance Sheet, June 30, 1952
D	Statement of Income and Loss August 8, 1951 to June 30, 1952
E	Pro Forma Balance Sheet, July 31, 1953
F	Pro Forma State of Income and Profit July 1, 1952 to June 30, 1953
G	Pro Forma Balance Sheet, July 31, 1954
H	Pro Forma Statement of Income and Profit July 1, 1953 to June 30, 1954
I	Pro Forma Balance Sheet, July 31, 1955
J	Pro Forma Statement of Income and Profit July 1, 1954 to June 30, 1955
K	Pro Forma Balance Sheet, July 31, 1956
L	Pro Forma Statement of Income and Loss July 1, 1955 to June 30, 1956

Schedules

1	Schedule of Cash Income by months - August, 1951 to June 30, 1956
2	Schedule of Cash Receipts July 1, 1956 - Aug. 18, 1956 and Estimated Average Annual Rentals.
3	Schedule of Insurance currently in effect.

GILBERT SUNSHINE

Certified Public Accountant

[fol. 10558]

EXHIBIT "A"

NAZARETH FAIRGROUNDS AND FARMERS MARKET

April 17, 1951

Purchase of Business by Morris Soble

Land and Building	$66000.00	
Settlement Costs	456.50	
Insurance	45.78	
Taxes	39.69	
Cost of Land and Building		$66541.97
Due thereon:		
Accrued Taxes	45.48	
Accrued Interest	263.50	
First Mortgage	8500.00	
Second Mortgage	10000.00	
Loan - Max Levy	5000.00	
Loan - Murray Realty Co.	2732.99	26541.97
Capital - Morris Soble		$40000.00

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

CHERNOFF SUNSHINE
Certified Public Accountants

[fol. 10559]

EXHIBIT "B-1"

NAZARETH FAIRGROUNDS & FARMERS MARKET

Balance Sheet - August 7, 1951

ASSETS

Current:	Cash in Bank		$ 1167.17	
	Cash on Hand		50.00	
	Prepaid Insurance		1284.00	$2501.17
Fixed:	Deposit as Security		50.00	
	Land		6000.00	
	Buildings	$60456.50		
	Less: Reserve for Depn.	806.09	59650.41	
	Improvements	979[illegible].64		
	Less: Reserve for Depreo.	717.66	9276.98	75277.39
Other:	Loan Receivable - Murry Realty			3615.52
Total Assets				$81394.08

LIABILITIES AND CAPITAL

Current:	Accrued Payroll		$ 95.00	
	Withholding & Payroll taxes payable		185.42	
	Accounts Payable		4477.74	34758.16
Other:	Loans Payable - Max Levy		2500.00	
	Loans Payable - Morris Soble		37000.00	
	Loans Payable - J. Malakoff		17489.00	
	First Mortgage Payable		8500.00	
	Second Mortgage Payable		9500.00	74989.00
Total Liabilities				79747.16
Capital:				
	Morris Soble, Capital		823.46	
	Milton Zolath, Capital		823.46	
Total Capital				1646.92
Total Capital and Liabilities				$81394.08

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10560]

EXHIBIT "B-2"

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Balance Sheet - August 8, 1951

ASSETS

Current:	Cash in Bank		$ 1157.17	
	Cash on Hand		50.00	
	Prepaid Insurance		1284.00	$2501.17
Fixed:	Deposits as Security		50.00	
	Land		6000.00	
	Building	$60456.50		
	Less:			
	Reserve for Depreciation	806.09	59650.41	
	Improvements	9794.54		
	Less:			
	Reserve for Depreciation	217.66	9576.98	75277.39
Other:	Loan Receivable - Murray Realty			3615.52
Total Assets				$81394.08

LIABILITIES AND CAPITAL

Current:	Accrued Payroll	$ 95.00	
	Withholding and Payroll taxes payable	186.42	
	Accounts Payable	4477.74	$4758.16
Other:	Loans Payable - M. Soble	37073.46	
	Loans Payable - K. Zolath	73.46	
	Loans Payable - Max Levy	2500.00	
	Loans Payable - J. Malakoff	17489.00	
	First Mortgage Payable	6500.00	
	Second Mortgage Payable	9500.00	75135.92
Total Liabilities			79894.08
Capital:			
	Capital Stock:		
	Authorized, 200 shares, no par		
	Issued and outstanding 20 shares		1500.00
Total Liabilities and Capital			$81394.08

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10561]

EXHIBIT "C"

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Balance Sheet - June 30, 1952

ASSETS

Current:	Cash in Bank		$ (371.40)	
	Cash on Hand		50.00	
	Prepaid Insurance		3284.44	$2963.04
Fixed:	Deposit as Security		50.00	
	Land		6000.00	
	Buildings	$70543.50		
	Less: Reserve for Dep.	3228.37	67315.13	
	Improvements	12256.14		
	Less: Reserve for Dept.	849.88	11606.26	84971.39
Other:	Organization Expenses			349.65
Total Assets				$88284.08

LIABILITIES AND CAPITAL

Current:	Accrued Payroll	$ 160.50	
	Withholding taxes payable	104.40	
	F.C.A.B. taxes payable	91.24	
	Unemployment taxes payable	78.62	
	Accounts payable	589.61	$1024.37
Other:	Notes Payable - Insurance Financing	2781.24	
	Loans Payable - J. Malakoff	6892.92	
	First Mortgage Payable	8500.00	
	Second Mortgage Payable	8000.00	87374.16
Total Liabilities			88398.53
Capital and Surplus:			
	Capital Stock:		
	Authorized, 200 shares, no par		
	Issued and outstanding, 20 shares	1500.00	
	Deficit per Exhibit D	(1514.45)	
Deficit in Capital			(114.45)
Total Liabilities and Capital			$88284.08

( ) Denotes red figures.

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10562]

EXHIBIT "F"

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Pro Forma Statement of Income and Profit
July 1, 1952 to June 30, 1953

Income:		
Rental Income - market	$41761.58	
Rental Income - race track	5086.55	
Concession Commissions	6117.27	
Miscellaneous Income	2668.16	
Rodeo Rental	1000.00	
Total Income		$56633.56
Operating Expenses:		
Salaries	12965.63	
Payroll taxes	595.00	
Market Supplies & Expense	4984.08	
Heat, Light & Power	5830.86	
Cleaning & Sanitation	2279.14	
Garbage Disposal	893.00	
Water	239.96	
Insurance	2774.26	
Repairs	10904.46	
Office Expenses	563.20	
Dues	20.00	
Telephone	1143.09	
Professional Fees	1615.50	
Travel	19.98	
Advertising	6740.04	
Entertainment	170.00	
Bank Charges	37.40	
Interest	644.48	
General Taxes	324.00	
Depreciation: Buildings	2821.74	
Depreciation: Improvements	1389.68	
Total Operating Expenses	56609.40	
Less: Purchase Discounts	199.21	
Net	5[illegible]3.19	
Less: Insurance proceeds recoverable for losses applicable to expenditures incurred	11211.78	
Net Operating Expenses		44501.41
Operating Profit		12042.17
Less: Loss on Sale of Heater		850.04
Net Profit for the period		$11192.13

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10563]

EXHIBIT "G"

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Pro Forma Balance Sheet - June 30, 1954

ASSETS

Current:	Cash in Bank - Nazareth, Pa.		$(1152.10)	
	Cash in Bank - New York, N. Y.		(557.46)	
	Cash on Hand		70.25	
	Accounts Receivable - J. Malakoff		11611.78	
	Accounts Receivable - others		2000.00	
	Prepaid Insurance		1360.22	
	Prepaid Expenses		225.35	$13726.64
Fixed:	Deposit as Security		250.00	
	Land		6000.00	
	Building	$74177.96		
	Less: Reserve for Dep.	8948.45	65229.51	
	Improvements	30059.27		
	Less: Reserve for Dep.	4369.39	25689.88	97169.39
Other:	Loans Receivable - J. Malakoff		3898.85	
	Loans Receivable - others		1082.03	
	Organization Expenses		349.65	5330.53
Total Assets				$116226.56

LIABILITIES AND CAPITAL

Current:	Accrued Payroll	$ 565.35	
	Withholding Taxes Payable	760.98	
	F.C.A.B. Taxes Payable	153.83	
	Unemployment Taxes Payable	241.86	
	Accounts Payable	18968.56	20690.58
Other:	Notes Payable - Insurance Financing	2694.10	
	Notes Payable - others	1000.00	
	Loans Payable - J. Malakoff	68442.92	
	Loans Payable - others	503.95	
	First Mortgage Payable	8500.00	
	Second Mortgage Payable	4000.00	85140.97
Total Liabilities			105831.55
Capital and Surplus:			
	Capital Stock:		
	Authorized 200 shares, no par		
	Issued&outstanding, unknown	1500.00	
	Surplus 7/1/53 $ 9577.68		
	Add: Profit per Exhibit B 2117.33		
	Surplus 6/30/54	11695.01	
Total Capital and Surplus			11195.01
Total Liabilities and Capital			$116826.56

( ) Denotes red figures.

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE

Certified Public Accountants

[fol. 10564]

EXHIBIT "P"

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Statement of Income and Loss -
August 8, 1951 to June 30, 1952

Income:		
Rental Income - market	$37454.63	
Rental Income - race track	933.17	
Commissions	323.46	
Miscellaneous	468.98	
Total Income		$39180.24
Operating Expenses:		
Salaries	2074.74	
Payroll Taxes	383.25	
Market Supplies & Expenses	1758.39	
Heat, Light & Power	2567.89	
Cleaning & Sanitation	1393.00	
Garbage Disposal	196.50	
Water	291.51	
Insurance	1435.79	
Repairs	4813.64	
Office Expenses & Services	2410.00	
Telephone	191.76	
Professional Fees	390.00	
Travel & Entertainment	2496.66	
Truck Expenses	568.00	
Advertising	2966.14	
Bank Charges	29.46	
Interest	953.86	
General Taxes	136.71	
Depreciation Buildings	2422.28	
Depreciation Improvements	732.22	
Total Operating Expenses	41211.80	
Less: Insurance proceeds recoverable for losses applicable to expenditures incurred	417.11	
Net Operating Expenses		40794.69
Net Loss for the period		$(1614.45)

( ) Denotes red figures.

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10565]

EXHIBIT "E"

NAZARETH FAIRGROUNDS & FARMERS MARKET, INC.

Pro Forma Balance Sheet - June 30, 1953

ASSETS

Current:	Cash in Bank		$ (471.93)	
	Cash on Hand		70.25	
	Accounts Receivable - J. Malakoff		11811.78	
	Prepaid Insurance		5662.60	
	Prepaid Expenses		262.24	$17354.94
Fixed:	Deposit as Security		50.00	
	Land		6000.00	
	Building	$70543.50		
	Less: Reserve for Dep.	6050.11	64493.39	
	Improvements	22770.19		
	Less: Reserve for Dep.	2204.60	20565.59	91108.98
Other:	Loans Receivable - J. Malakoff		3898.85	
	Organization Expenses		349.65	4248.50
Total Assets				$112711.42

LIABILITIES AND CAPITAL

Current:	Accrued Payroll	253.90	
	Withholding taxes payable	126.56	
	F.C.A.B. taxes payable	36.57	
	Unemployment taxes payable	175.32	
	Accounts payable	10068.84	10610.39
Other:	Notes Payable - Insurance Financing	5185.71	
	Notes Payable - others	1000.00	
	Loans Payable - J. Malakoff	6842.92	
	Loans Payable - others	1895.72	
	First Mortgage Payable	9500.00	
	Second Mortgage Payable	6090.00	31024.35
Total Liabilities			101634.74
Capital and Surplus:			
	Capital Stock:		
	Authorized, 200 shares, no par		
	Issued and outstanding, 20 shares	1500.00	
	Deficit 7/1/52	$(1614.55)	
	Add: Profit per Exh. F	11192.23	
	Surplus 6/30/53	9577.68	
Total Capital and Surplus			11077.68
Total Liabilities and Capital			$112712.42

( ) Denotes red figures.

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10566]

EXHIBIT #48

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Pro Forma Statement of Income and Profit
July 1, 1957 to June 30, 1958

Income:			
	Rental Income - market	$44747.76	
	Rental Income - race track	7455.69	
	Concession commissions	7753.76	
	Other income	2392.04	
Total Income			$61949.27
Operating Expenses:			
	Salaries	19452.98	
	Payroll Taxes	855.25	
	Market Supplies & Expenses	1734.67	
	Heat, Light & Power	6307.75	
	Cleaning & Sanitation	2704.30	
	Garbage Disposal	658.00	
	Water	326.50	
	Insurance	3706.15	
	Repairs	2086.70	
	Office Expenses	696.46	
	Dues	20.00	
	Telephone	805.01	
	Professional Fees	8015.50	
	Travel	612.00	
	Advertising	737.62	
	Bank Charges	62.20	
	Interest	856.41	
	General Taxes	520.00	
	Depreciation: Building	2894.34	
	Depreciation: Improvements	2164.79	
Total Operating Expenses		61846.63	
Less:	Purchase Discounts	214.69	
Net		61631.94	
Less:	Insurance Proceeds recoverable for losses applicable to expenditures incurred	2000.00	
Net Operating Expenses			59631.94
Net Profit for Period			$ 2317.33

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10567]

EXHIBIT "I"

NAZARETH FAIRGROUNDS & FARMERS MARKET, INC.

Pro Forma Balance Sheet - June 30, 1955

ASSETS

Current:	Cash in Bank - Nazareth, Pa.		$(1152.10)	
	Cash in Bank - New York, N. Y.		(487[illegible].95)	
	Cash on Hand		70.25	
	Accounts Receivable - J. Malakoff		11811.78	
	Accounts Receivable - others		12283.62	
	Prepaid Insurance		3129.23	
	Prepaid Expenses		127.43	$21395.26
Fixed:	Deposit as Security		250.00	
	Land		6000.00	
	Building	$106815.57		
	Less: Reserve for Dep.	12569.23	94246.34	
	Improvements	37925.91		
	Less: Reserve for Dep.	7390.25	30535.66	131032.00
Other:	Loans Receivable - J. Malakoff		3898.85	
	Loans Receivable - others		1082.03	
	Organization Expences		349.65	5330.53
Total Assets				$157757.79

LIABILITIES AND CAPITAL

Current:	Accrued Payroll		$ 888.29	
	Withholding Taxes Payable		710.20	
	F.C.A.B. Taxes Payable		225.93	
	Unemployment Taxes Payable		342.74	
	Accounts Payable		37824.77	$39991.93
Other:	Notes Payable-Insurance Financing		1461.33	
	Notes Payable - others		1000.00	
	Loans Payable - J. Malakoff		68442.92	
	Loans Payable - others		503.95	
	First Mortgage Payable		8500.00	
	Second Mortgage Payable		2000.00	
	Third Mortgage Payable		14000.00	95928.20
Total Liabilities				$135920.13
Capital and Surplus:				
	Capital Stock: Authorized 200 shares, no par; issued and outstanding, unknown		1500.00	
	Surplus 7/1/54	$11895.01		
	Add: Profit per Exhibit J	8442.65		
	Surplus 6/30/55		20337.66	
Total Capital and Surplus				21837.66
Total Liabilities and Capital				$157757.79

( ) Denotes red figures.

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10568]

EXHIBIT "J"

NAZARETH FAIRGROUNDS & FARMERS MARKET INC

Pro Forma Statement of Income and Profit
July 1, 1954 to June 30, 1955

Income:			
	Rental Income - market	$51689.70	
	Rental Income - race track	5210.25	
	Concession Commissions	7807.36	
	Other Income	1853.19	
Total Income			$66558.50
Operating Expenses:			
	Salaries	21709.90	
	Payroll Taxes	1193.34	
	Market Supplies & Expenses	1569.03	
	Heat, Light & Power	6751.37	
	Cleaning & Sanitation	2625.05	
	Garbage Disposal	248.00	
	Water	437.70	
	Insurance	5213.96	
	Repairs	15871.60	
	Office Expenses	648.32	
	Dues	20.00	
	Telephone	903.25	
	Professional Fees	2300.00	
	Travel	756.50	
	Advertising	737[illegible].49	
	Bank Charges	85.51	
	Interest	9[illegible].52	
	General Taxes	567.50	
	Depreciation Buildings	36[illegible].78	
	Depreciation Improvements	3020.86	
Total Operating Expenses		76097.34	
Less:	Purchase Discounts	178.78	
Net		75[illegible].62	
Less:	Insurance proceeds recoverable for losses applicable to expenditures incurred	17352.77	
Net Operating Expenses			58115.85
Net Profit for Period			$ 8442.65

Note: This Exhibit is subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10569]

EXHIBIT "K"

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Pro Forma Balance Sheet - June 30, 1956

ASSETS

Current:	Cash in Bank - Nazareth, Pa.		$ (1152.10)	
	Cash in Bank - New York, N. Y.		(3457.04)	
	Cash on Hand		70.25	
	Accounts Receivable - J. Malakoff		11811.78	
	Prepaid Insurance		8922.24	
	Prepaid Expenses		762.33	$16961.46
Fixed:	Deposit As Security		250.00	
	Land		6000.00	
	Building	$106815.57		
	Less: Reserve for Dep.	16841.84	89973.73	
	Improvements	41254.82		
	Less: Reserve for Dep.	10693.18	30761.64	126985.37
Other:	Loans Receivable - J. Malakoff		3898.85	
	Loans Receivable - others		1082.03	
	Organization Expenses		349.65	5330.53
Total Assets				$148877.36

LIABILITIES AND CAPITAL

Current:	Accrued Payroll	$ 695.14	
	Withholding Taxes Payable	687.08	
	F.O.A.B.Taxes Payable	165.58	
	Unemployment Taxes Payable	158.35	
	Accounts Payable	24520.70	$26226.85
Other:	Notes Payable - Insurance Financing	11175.46	
	Notes Payable - others	1000.00	
	Loans Payable - J. Malakoff	68442.92	
	Loans Payable - others	326.20	
	First Mortgage Payable	8500.00	
	Second Mortgage Payable	---	
	Third Mortgage Payable	11900.00	101344.58
Total Liabilities			127571.43
Capital and Surplus:			
	Capital Stock:		
	Authorized 200 shares, no par		
	Issued and outstanding, unknown	1500.00	
	Surplus 7/1/55	$20337.66	
	Loss per Exhibit L	(531.73)	
	Surplus 6/30/56	19805.93	
Total Capital and Surplus			21305.93
Total Liabilities and Capital			$148877.36

( ) Denotes red figures.

Note: These Exhibits are subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10570]

EXHIBIT "L"

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Pro Forma Statement of Income and Loss
July 1, 1955 to June 30, 1956

Income:		
Rental Income - market	$64356.13	
Rental Income - race track	5807.72	
Concession Commissions	7046.06	
Other Income	1771.85	
Total Income		$78981.76
Operating Expenses:		
Salaries	26979.10	
Payroll Taxes	995.00	
Market Supplies & Expenses	2703.13	
Heat, Light & Power	12066.81	
Cleaning & Sanitation	3362.12	
Water	567.70	
Insurance	5277.73	
Repairs	3243.54	
Office Expenses	1803.66	
Dues	20.00	
Telephone	1025.24	
Professional Fees	1012.93	
Travel	443.00	
Advertising	12090.24	
Bank Charges	111.54	
Interest	2107.39	
General Taxes	837.50	
Depreciation: Building	4272.61	
Depreciation: Improvements	1502.93	
Total Operating Expenses	82518.17	
Less: Purchase Discounts	4.68	
Net operating expenses	82513.49	
Less: Damage claim received	3000.00	79513.49
Net Loss for Period		$ (531.73)

( ) Denotes red figures.

Note: These Exhibits are subject to the comments in Letter of Transmittal which is a part of this Exhibit.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10571]

SCHEDULE 1

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Schedule of Cash Income by Months
August 1951 - June 1956

	8/7/51 to 6/30/52	7/1/52 to 6/30/53	7/1/53 to 6/30/54	7/1/54 to 6/30/55	7/1/54 to 6/30/56
July	- -	5948.44	6761.59	6503.82	8136.10
Aug.	2035.12	4934.89	6548.71	6201.21	7004.56
Sep.	5345.80	6021.07	6123.78	6610.35	6535.48
Oct.	4270.15	5840.87	5949.79	5863.32	6193.78
Nov.	3372.17	4500.28	4432.90	4306.89	6190.22
Dec.	2714.37	3999.32	4546.39	3792.51	6590.56
Jan.	2484.95	3419.49	3279.39	3581.83	5324.39
Feb.	2900.59	2649.89	2621.61	3034.36	5337.42
Mar.	3143.75	3128.50	4133.89	3917.43	5601.25
Apr.	3436.29	4614.33	5025.72	5120.21	6326.17
May	4194.94	5230.22	6265.26	6674.09	7770.95
June	4364.11	6670.51	7410.25	7242.48	7972.33
Less: Journal Entrees for re turn rents		(155.00)	(111.79)	(10.00)	(182.00)
Add: Alvance Rentals received				2375.00	
Add: Rents Received by Court Action				822.00	177.75
Rents as per Exhibits C, F, H, J, L	39140.24	56671.58	61999.87	66558.50	78951.76

Note: These Schedules are subject to the comments in Letter of Transmittal which is a part of this report.

GILBERT SUNSHINE
Certified Public Accountant

[fol. 10572]

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Notes to Exhibits

Major items whose disposition effect these Exhibits:

(1) Federal and State Tax Returns have been filed for the year ending June 30, 1952.

(2) Number of stockholders, valid shares issued, the price thereof, and to whom paid.

(3) Any monies that may have been returned to purported or valid stockholders from a special bank account in the Corporate name, not reflected herein.

(4) Validity of loans and notes payable to individuals.

(5) The correct amount of the insurance proceeds recoverable from the storm loss in the year ending June 30, 1953 and the disposition of the monies.

(6) Salary payments claimed. None have been accrued for the manager pending this disposition. Salaries for him are reflected only from the date of Debtors entry into reorganization proceedings, paid per Court order.

(7) The validity of any judgment or suits now pending against the Debtor.

(8) Collectability of Loans and Accounts Receivable which are shown herein.

(9) Accuracy of bills reflected herein, and not paid to date for indebtedness incurred prior to date of reorganization proceedings.

Advance rentals of $2375.00 received in the fiscal year ending June 30, 1955 under lease agreements, included in Schedule "1," properly apply to the year ending June 30, 1956.

Gilbert Sunshine
Certified Public Accountant

Note: These Notes are subject to the comments in Letter of Transmittal which is a part of this report.

[fol. 10573]

NAZARETH FAIRGROUNDS & FARMERS MARKET INC.

Comments

History

Nazareth Fairground & Farmers Market was purchased April 17, 1951 by Morris Soble (see Exhibit "A"). Between April 17, 1951 and August 7, 1951, a partnership was formed for the business. It is not possible to ascertain all the partners, but at the end of the partnership, Morris Soble and Milton Zolath were the partners of record (see Exhibit "B-1").

Nazareth Fairgrounds and Farmers Market, Inc. (hereinafter called *Debtor*) was incorporated August 8, 1951 taking over the assets and liabilities of the partnership, for which 20 shares of stock were issued with a stated value of $1500.00 (see Exhibit "B-2"). The operations of the Debtor for the period August 8, 1951 to June 30, 1952 were examined by Waldbaum, Rochower & Company C.P.A.'s, of Philadelphia, Pa., who prepared and filed Federal and State tax returns for the period concerned (see Exhibits "C" and "D"). The business continued until September 28, 1953, when a petition for reorganization of the Corporation was filed in the United States District Court for the Southern District of New York. In the proceedings for the reorganization, assigned case number 896691, Debtor remained in possession.

Area

Debtor owns approximately 32 acres of ground, comprising rental areas, which includes a race track, grounds and buildings.

Buildings A to E were on the property prior to the fire, August 28, 1956. Building A approximately 9000 sq. ft., building C approximately 7776 sq. ft., and building E (known as the grandstand building, inasmuch as a grandstand is erected over it) approximately 7488 sq. ft., were on the grounds at the time of original purchase on April 7,

1951. Building B, approximately 4000 sq. ft. was completed on January 1, 1952, connecting buildings A and C. In May 1955, building D, approximately 21000 sq. ft., was erected with the approval of the Court, connecting buildings C and E, thereby making the Market Buildings one complete area of approximately 49,264 sq. ft. The proposed floor space to be rebuilt is approximately 70,000 sq. ft., which together with the remaining grandstand building, would give a total floor space of 77,488 sq. feet for renting. In addition, while the Nazareth Agricultural Fair was in existence, it erected two cinder block sheds on the hill area of the property. Said organization was dispossessed for non-payment of rent in 1956, with the buildings reverting to the Debtor. They have not, subsequently, been rented.

Addenda

Debtor is not a real estate corporation as such, but is also responsible for the development and promotion of its market sales. Debtor began operations in August of 1951 with unconnected Buildings, at a cost of $70453.50 and [fol. 10574] covering approximately 34264 sq. ft. It grew until it encompassed in Buildings, all connected, approximately 24264 sq. ft., almost doubling in size, with the cost of Buildings increasing to $106815.57 as of June 30, 1956. During tais same period, Improvements were made to the grounds from $12556.14 to $41254.82.

A glance at Schedule 1, Cash Income by months, indicates this transition most clearly. Schedule 2, showing the average Annual Rentals receivable before the fire of $93648.60 shows the gross income that approximately would now have been Debtor's. Schedule 1 further shows that this development of income arose through evening the collection by months. This goal was attained by attaining year round attendance by the merchants. It will be noted that until the last building, referred to as Building D, which was erected during the period of reorganization with the approval of the Court, that it was not possible to attain the level of occupancy in the months from November to March that prevailed throughout the year. The extensive advertising campaign in the fiscal year ending June 30, 1956 plus

the uninterrupted shopping area provided the year round merchant rentals. It must also be noted that in addition to paying increased rentals, the merchants had begun to underwrite the advertising campaign from their funds, thus enabling the Debtor to revert to its normal advertising program.

Prospects

The Debtor, though losing Buildings A to D in the fire was covered by insurance (see Schedule 3). Rental insurance will provide the Debtor with its average income until it is rebuilt. Little, however, will be collectable from the source, if rebuilding is unduly deferred or cancelled. With the proposed floor space to be rebuilt giving a total rental area of approximately 77488 sq. ft., the average annual rentals should at least produce one quarter to one third additional rental income. Such increase will be most profitable in that additional annual expenditures to maintain the operations of the Debtor will be at a minimum.

GILBERT SUNSHINE
Certified Public Accountant

Note: These Comments are subject to the comments in Letter of Transmittal which is a part of this report.

[10575]

SAUL, GENERAL: EXAMINER'S EXHIBIT CA

(S.M. 9638, 5/7/59; MLR Letter to Sugarman, J., 5/29/59)

AGREEMENT OF THE STOCKHOLDERS

of

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.

AGREEMENT made as of December 1st, 1957, by and between the undersigned who are all stockholders of NAZARETH FAIR GROUNDS & FARMERS MARKET, INC. (herein called the "Corporation");

1. Each of the parties agrees that upon receipt of a bona fide offer to purchase all or any part of the stock held by them, which is intended to be accepted, or before entering into any contract for the sale thereof, he or she (as the case may be) must first offer the same for sale to the remaining parties hereto.

2. The offer to the remaining parties shall be made to them by registered mail, c/o Arnold A. Weinstein, 225 Broadway, New York City and on the same terms and conditions as the offer received or the proposed contract of sale and shall be accompanied by a copy of the offer or proposed contract. The name and address of the proposed purchaser shall also be stated.

3. The remaining parties shall have the option to purchase such stock as is intended or proposed to be sold in the proportion to which their stock bears to the total number of shares held by the remaining parties within Thirty (30) days from the date of receipt by them of the offer to sell. Acceptance of the offer shall be by registered mail and shall fix a closing date and place not later than Ten (10) days thereafter. Should any of the remaining stockholders decline to exercise his option, the remainder shall succeed to such option in the foregoing proportion.

[fol. 10576] 4. Should there be no exercise of the foregoing option, the stock of the party making the offer to the remaining parties shall be free of all restrictions on the sale thereof. There shall be no restriction in the event all of the offered shares are not purchased.

5. This agreement shall expire on December 1st, 1959, and shall not apply to transfers to a member of the immediate family of a party who takes subject to this agreement.

IN WITNESS WHEREOF, the parties have executed this agreement as of the date first above written.

Name	*Address*
Arnold A. Weinstein	225 Broadway, New York City
Jerome Fried	Eichlin Rd. & Haupt St. Easton, Pa.
Aaron Fried, per Jerome Fried	2766 University Ave. Bronx, N.Y.C.
Harry Forman	49 W. 32nd St. N.Y.1
Louis P. Como	1725 York Ave. N.Y.28
Frank Como LC	1725 York Ave. N.Y.28
Patsy Como LC	1725 York Ave. N.Y.28
Cydney Grossman	41—5th Ave. N.Y.C.
George Bond per Cydney Grossman	41—5th Ave. N.Y.C.
Robert A. Noira, by N. Kohn	10 West 65 St. N.Y.C.
H. Lawrence Lamphaimer	20 Fara Drive, Stamford, Conn.
Barry Clark	315 E. 88th St. N.Y.C.
Lazar Karapontso	160 W. 73 St. N.Y.C.
Dorothy Holober Clark	315 E. 88 St. N.Y.C.

Saul, General: Examiner's Exhibit G
(Closing Statement)

COMMONWEALTH TITLE COMPANY OF PHILADELPHIA

1510 WALNUT STREET
PHILADELPHIA 2

No. X-141889

4/17/51

Grantor Nazareth Fairgrounds Inc

Grantee Richard Realty Company

Premises Nazareth - Fairgrounds Pa

		Dr.		
Consideration	subject to mtge 55M	57500 00		
Taxes of Current Year				
Water Rent	"			
House Rent				
Acknowledgment of Deed		50		
Fire Insurance	P 61575 Mutual Fire	34 33		
	A 61708 Corona Mutual	11 45	57546	28
		Cr.		
Paid on Account		5000 00		
Taxes of Current Year	1530 - 3 mo 17 days	45 48		
Water Rent				
Mortgage Principal	2nd mtge	10000 00		
Interest on Mortgage	8500 - 1%/50 To 4/17/51	263 50		
House Rent			15308	98
		Balance Due Grantor	42237	30

COPY

SETTLEMENT WITH GRANTOR

$42237.30

Mortgage [redacted]

SETTLEMENT WITH GRANTEE

Fund Due Grantor $42237 30

Realty 6
Survey 52 00
Recordings 4 50 56 50

Balance Due Grantor 42237 30

SETTLEMENT WITH GRANTOR

$42237.30

[redacted]

Taxes (Current)

Taxes (Del.)

Water Rent (Current)

Water Rents (Del.)

Stamps 63 25

Recording

Affidavit & Acknowledgment 1 00 2076438

Balance Payable to Grantor $ 42172 92

SETTLEMENT WITH GRANTEE

Fund Due Grantor $42237 30

Realty Co

Survey 52 00

Recording 4 50 56 50

David Stark Coll

1951 Taxes 39 69

Stamps

Examination Fee	85	-	
Premium	287	50	
Settlement Fee	5	-	
Recording and Services — Deed	4	50	
Recording and Services — Mortgage	7	50	
Affidavit & Ack.	10	00	399 50

Fund Necessary to Complete Settlement $42 732 99

Deposited By $

Total

[fol. 10577]

COPY

The above settlement examined and approved, in consideration of which Commonwealth Title Company of Philadelphia is directed and authorized to make distribution and payments in accordance herewith if all its requirements in connection with the settlement and its title insurance have been fulfilled.

Approved

Grantors

Address

Approved

Grantees

Address

531

[fol. 10578]

SAUL, GENERAL: EXAMINER'S EXHIBIT I

(Debtor's Minute Book)

NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.

MINUTES OF FIRST MEETING OF THE BOARD OF DIRECTORS

The first meeting of the Board of Directors was held at Room 603, 1616 Walnut Street, Philadelphia 3, Pennsylvania, on the ninth day of August 1951 at ten o'clock A.M.

* * * * * * *

[fol. 10581] WHEREAS, it was the intention of the incorporators to purchase, take over and carry on the business known as The Nazareth Farmers' Market at Nazareth, Pennsylvania, now being operated by Milton R. Zoloth and Morris Soble and

WHEREAS, Mr. Zoloth, on behalf of the partnership, offered to sell the said business as a going concern to this corporation in consideration of the issuance to them of twenty shares of full paid and non-assessable shares of this corporation.

WHEREAS, in the judgment of this Board of Directors, after careful examination and fair appraisement, this Board is unanimously convinced that the said property is necessary and advantageous for the business of this corporation and the fair value thereof is the consideration mentioned in the said offer.

NOW THEREFORE, Be It Resolved:

That this Board accept the offer of Milton R. Zoloth and Morris Soble and purchase from them the business and property consisting of thirty-two acres of ground situated on the southwest corner of the intersection of Pennsylvania Routes Nos. 12 and 45 in Lower Nazareth Township, Pennsylvania, together with all of the assets of the said business as set forth in a copy of a balance sheet submitted by the said Milton R. Zoloth and Morris Soble, dated August 8, 1951 as follows:

[fol. 10582]

ASSETS			
Cash		$ 1,217.17	
Deposit		50.00	
Loans Receivable		3,615.52	
Land and Buildings	$66,456.50		
Improvements	9,794.64		
	76,251.14		
Less—Reserve for Depreciation	1,023.75		
NET BOOK VALUE		75,227.39	
Prepaid Insurance		1,284.00	
TOTAL ASSETS			$81,394.08

LIABILITIES AND NET WORTH

LIABILITIES		
Loans Payable	$57,135.92	
First Mortgage Payable	8,500.00	
Second Mortgage Payable	9,500.00	
Accrued Taxes and Expenses	4,758.16	
TOTAL LIABILITIES		$79,894.08
NET WORTH		1,500.00
TOTAL LIABILITIES AND NET WORTH		$81,394.08

FURTHER RESOLVED, That this corporation assumes the payment of all of the obligations of the partnership as set forth above and that the President and Secretary of this corporation are authorized and directed to issue and deliver in accordance with the terms of the said offer, certificates for twenty full paid and non-assessable shares of this corporation to the said Milton R. Zoloth and Morris Soble.

Upon motion, duly made, seconded and carried, it was

RESOLVED, That the proper officers of the corporation be and they hereby are authorized and directed in behalf of the corporation, and under its corporate seal, to make and file such certificate, report or other instrument as may

be required by law to be filed in any state, territory, or [fol. 10583] dependency of the United States, or in any foreign country, in which said officers shall find it necessary or expedient to file the same to authorize the corporation to transact business in such state, territory, dependency or foreign country.

The officers were instructed to register this corporation with the Department of Revenue at Harrisburg, Pa., as required by law, and to properly execute and file the necessary initial Bonus Report with the Department of State at Harrisburg, Pennsylvania.

Upon motion, duly made, seconded and carried, it was

RESOLVED, That the Treasurer be and he is hereby authorized to pay all fees and expenses incident to and necessary for the organization of the corporation.

There being no further business, the meeting upon motion adjourned.

/s/ Paul Laury
Secretary

[fol. 10584]

SAUL, GENERAL: EXAMINER'S EXHIBIT I

(Debtor's Minute Book)

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.

WAIVER OF NOTICE OF SPECIAL JOINT MEETING OF OFFICERS AND DIRECTORS.

We, the undersigned, being all the officers and directors of Nazareth Fair Grounds & Farmers Market, Inc., do hereby waive notice of the time, place and purpose of a special joint meeting of the officers and directors of the said coroporation.

We do hereby fix July 2nd, 1952 at 2 P. M. as the time and the Nazareth Fair Grounds, Nazareth, Pennsylvania as the place of the said meeting.

Dated—July 2nd, 1953

/s/ JOHN MALAKOFF
President & Director

/s/ JEROME FRIED
Secretary-Treasurer & Director

/s/ RICHARD S. HULL
Director

[fol. 10585]

SAUL, GENERAL: EXAMINER'S EXHIBIT I

(Debtor's Minute Book)

MINUTES OF A SPECIAL JOINT MEETING OF THE BOARD OF DIRECTORS AND OFFICERS OF NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.

A special joint meeting of the Board of Directors and Officers of Nazareth Fair Grounds & Farmers Market, Inc., was held at the Nazareth Fair Grounds, Nazareth, Pennsylvania on July 2nd, 1952 at 2 P. M. All of the directors,

consisting of John Malakoff, Jerome Fried and Richard S. Hull, were present. All of the officers, consisting of John Malakoff, President and Jerome Fried, Secretary-Treasurer, were present.

The meeting was called to order by the president and the minutes were recorded by the secretary. The president advised the meeting that there are approximately $66,092.92 in loans, payable to John Malakoff according to the books and records of the corporation and he further advised the meeting that in accordance with the statement set up in the minutes of August 9th, 1951, the net worth of the corporation was $1500.00. Since twenty shares of stock had been issued, the value of the stock was $75.00 per share. He further advised that the said John Malakoff was willing to liquidate $13,500.00 of the obligation due him by accepting one hundred eighty shares of stock at the same $75.00 per share. After considerable discussion, it was, on motion made seconded and unanimously carried,

1 of 2

[fol. 10586] RESOLVED, that the Nazareth Fair Grounds & Farmers Market, Inc., issued to John Malakoff or his designee, one hundred eighty shares of stock, in reduction of the sum of $13,500.00 against the amount due the said John Malakoff, and, that the officers of the corporation be, and they are hereby authorized and directed to issue said shares of stock to the said John Malakoff, or to his designee, in such denomination and at such times as he may request.

There being no further business, the meeting was, on motion adjourned.

/s/ Jerome Fried
Secretary.

Dated—July 2nd, 1953

I, the undersigned, John Malakoff, do hereby accept the terms of the resolution herein referred to and will, from time to time direct the corporation to issue the said one hundred eighty shares of stock in such denominations as I may advise them.

/s/ John Malakoff

July 2nd, 1952

2 of 2

Saul, General: Examiner's Exhibit J
(Ledger Sheet - Philadelphia Group)

[fol. 10587]

Nazareth Farmground

18 459
PHILADELPHIA LEDGER

1951					1951				
Sept 17	Cash - Clearance Bank & Tr Co	CR 30	X	50000	Sept 10	open Bank & Trust Co	CR 12	X	50000
17	Comm Title Co 6 Mo Due 4/11/51	CR 21		42 73299	13	M Sable	CR 12		40000
17	R Metzger & M Erickson	CR 21		25500	June 26	J Malakoff	CR 12		37500
19	Deposit Nazareth Bank	CR 21		100000	July 7	J Malakoff	CR 14		100000
May 3	Wm Edelman & Co grading 28799	CR 24		44487 99 685 49	Aug 16	"	CR 15		22500
7	E Malakoff Transfer Tax & Tr Co	CR 25		500000	18	" Balance	CR 15		73900
June 11	M Sable	CR 32		50173 48 25000 00	18	" 1/4 Improvements	CR 15		7500
July 17	M Zeltzer Transfer Tax & Tr Co	CR 38		52673 48 1700000	Sept 11	J Malakoff 2815.52 ~~3815.52~~	CR 25		500000
Sept 14	M Sable	CR 47		54373 48 250000	13	J Malakoff ~~3615.52~~	CR 25		500000
Oct 16	M & Co	CR 53		56873 48 1115 52	21	J Malakoff ~~16,115.52~~	CR 26		500000
19	M Sable	CR 53		57988 00 250000	Oct 16	"	CR 28		250000
24	" "	CR 53		500000	24	"	CR 29		250000
26	" "	CR 53		250000	25	"	CR 29		250000
Nov 7	" "	CR 56		67988 00 200000	29	"	CR 29		200000
8	" "	CR 57		500000	Dec 10	J Malakoff	CR 35		2553 05
15	" "	CR 64		77988 00 300000					
Dec 1	" "	CR 67		10000000 87988 00					

2146.92

M & Co - 7346 M 2
37 073 46 : M 5
1,UC 92
2.853 05 M 2 : M 5
40,000 00

EXHIBIT
U. S. Dist. Court
S. D. of N. Y.
MAY 23 1958

[fol. 10588]

Nazareth Fairgrounds

18-459 1/4BAX "EYE EASE" HAMMERMILL LEDGER

1952					1952				
Jan	1		✓	2146 92	Jan	3	J Malahoff	CR 7	2146 92
Dec	29	Penna Dept of Revenue	CP 66	661 86	Feb	15	J Malahoff & Nazareth	CR 7	2000 00
	29	M Labella	CP 66	1000 00	Sept	22	Caledonia Ins Co	CR 33	2586 20
				1661 86		22	Ins Co N A	CR 33	1844 26
Nov	5	Caledonia Ins Co Adjustment	CP 68	15 83		22	Hanover Fire Ins	CR 33	1539 00
	5	Hanover Fire Ins Co	CP 68	11 93					7969 46
	5	Ins Co N A	CP 68	14 81	Oct	27	Mass Fire	CR 38	1953 77
				17044 43		27	Royal Ins	CR 38	1740 42
						27	Aetna Ins Co	CR 38	1562 34
						27	Nat'l Union Fire ~~13,547.86~~	CR 38	1953 77
									15179 46
							13,475.33		

[fol. 10589]

SAUL, GENERAL: DEBTOR'S EXHIBIT F

Title Inc.—Comm Title 4/17/51—# X 141889

AGREEMENT made this 17th day of October, A. D. 1951,

WITNESSETH, That, Milton R. Zoloth and Morris Soble, hereinafter called the Sellers, agree to sell their Twenty (20) ~~Fifteen (15)~~ shares of NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., stock to

hereinafter called the Buyer, who agrees to buy these shares for the sum of Thirty-Two Thousand, Eight Hundred fifty-three Dollars and eight cents ($32,853.08) payable as follows: Two Thousand, eight Hundred fifty-three Dollars and eight cents ($2,853.08) payable upon the signing of this agreement, and the balance of Thirty Thousand Dollars ($30,000.00) in ten (10) equal monthly installments of Three Thousand Dollars ($3,000.00) each, the first installment of which is due on November 17th, 1951 and monthly thereafter. The aforementioned ~~fifteen (15)~~ Twenty (20) shares constitute one hundred percent (100%) of all issued stock of the Nazareth Fair Grounds & Farmers' Market, Inc.

Title of stock to pass to Buyer immediately upon payment of aforementioned sum of Two Thousand eight hundred fifty-three Dollars and eight cents ($2,853.08). Said stock to be held in escrow by Edward Malakoff until full amount of purchase price is paid to the Sellers. Buyer is to have full rights to any and all dividends in this stock but Sellers retain voting rights of stock until such time as full payments shall have been made by Buyer.

Should Buyer fail to make payments as hereinabove provided, the sum or sums paid on account are to be retained by Sellers, either on account of purchase money, or as compensation for the damages and expenses they have been put to in this behalf, as the Sellers shall elect, and in the latter case this contract shall become null and void and all copies to be returned to Sellers for cancellation.

[fol. 10590] This Agreement to extend to and be binding upon the heirs, executors, administrator and assigns of the parties hereto.

IN WITNESS WHEREOF, the said parties have hereunto set their hands and seals the day and year first above written.

.....(SEAL)

/s/ JOHN MALAKOFF (SEAL)

.....(SEAL)

Sealed and delivered
in the presence of:

.....

.....

We hereby acknowledge the receipt of Two Thousand, Eight Hundred Fifty-three Dollars and eight cents ($2,853.08) from the buyer.

.....

.....

3700-3704 Angelina Ave

Saul, General: Debtor's Exhibit K
(Malakoff record book)

4/13/51

Contract dated 13th - at Bernard S. White atty
690 Anderson Ave - Cliffside Park, N.J.
Cliffside 6-11-21 - Broker Von Schrader & Ed Stanfield
Purchase Price 145.000
1st mtge 95,000
2nd " 15.000
Cash 35.000
On Contract 7,500 (Given by R. Hall)
Title July 2, 1951 as of June 1st

		Ret. Deposit 4/19	Profit	
B. Margolis	2/6	2500	600 =	4/2
F. Kaffenell	1/6	1250	300	4/3
Chas. Kantor	1/6	1250	300	4/4
Stanberg	2/6	1250	300 =	4/6
Feitelberg	1/6	1250	300	4/7

Re Sale:
Sold to M. Manuel - 7500
Broker Stanfield & Von Schrader 2500 =
Atty fees 200 =

Allowance M. M. - 1000 = plus 200 = fees
Total Profit for syndicate 1800 =

[fol. 10591]

10591

	20		200
	22		500
	10	1500	
	16	1000	
	22	1000	
	28	1000	
OCT	14	2000	
	14	1000	
	24	1100	
	31		2100
	10		3000
NOV	17		1500
	18		525
	25		1000
	15		775
	13	1300	
	10	1500	
	V	1000	
DEC	1		2500
	15		204650
	22		1700
	24		400
	25		200
	26		1200
	27		4200
	27		200
	30		100
	30		4000
	30		400
	31		200
	11/28	1500	
	11/28	1000	
	26	2500	
	12	204650	
	18	1700	
	22	3000	
	22	2500	
	31	100	
	31	100	
FORWARD		3040450	2404650

142 N. 103

Contract 4/20 - Jacob Arndt - atty

Price 5,000 Cash over mtge -

4/20 Chas. Kanter -

~~Subscribed 500 Preferred~~

M. Kapp. Pref	100		
Kapp	100	Pd - May 1950 - Cash -	
Chas Kanter	100	Pd " 1950 -	
abstract - atty	100	Pd " 1950 -	
atty -	100	Pd -	
Sec Co -	500		

10592

[fol. 10592]

Nazareth

1/3 Int

1/4 Interest

Repairs –
5/18 Grading 2795 10
200 Sub Ba 788
30 Tops – 45
10 Alle 25
Labor – Painting
Electric wiring

10593

[fol. 10593]

[redacted]

L - Court
D. . . Y.
T. . . 1958

J. MALAKOFF
EXCHANGE A/C
1952

		DR	CR
JULY	3	500	
	16	1000	
	23	63	
	23	1000	
	23	1000	
AUG	28		1000
SEPT	10		500
	17		800
	20		200
	22		500
	10	1500	
	16	1000	
	22	1000	
	28	1000	
OCT	14	2000	
	14	1000	
	24	1100	
	31		2100
	10		3000
NOV	17		1500
	18		525
	25		1000
	15		775
	13	1300	
	10	1500	
	4	1000	

J MALAKOFF
EXCHANGE A/C
1953

			DR	CR
BALANCE FORWARD			30409 50	39546 50
JAN 1953	4			3000
	4			500
	16			2500
	23			3000
		dates unknown	200	
			500	
			3000	
		5	100	
		7	100	
		7	100	
FEB	3			300
		1	100	
MAR		1	100	
	17			300
	5		300	
	4			700
APRIL		1	100	
MAY		27	3525	
		1	100	
JUNE		1	100	
	3	3	300	
		17	500	
		11	3323	
			4167	
			43444 75	39546 50
BALANCE			3898 25	

[fol. 10595]

[fol. 10596]

SAUL, GENERAL: DEBTOR'S EXHIBIT O

BENJAMIN MARGOLIS
ATTORNEY AT LAW
271 NORTH AVENUE
NEW ROCHELLE, N. Y.
NEW ROCHELLE 2-3100

May 25, 1953

Richard S. Hull, Esq.
393 Seventh Avenue
New York, N. Y.

Re: Nazareth Fair Grounds & Farmers Market Inc.

Dear Sir:

In going over the books and records of the corporation it appears among other things: 1. That no meeting of the stockholders or directors were held. 2. That stock of the corporation was issued without the money being put in the corporate treasury. 3. That the proceeds of checks given for windstorm losses in July, 1952 were not used in accordance with law. I refer in particular to the settlement made by Young Adjustment Co. with Murray Realty Co. in July, 1952 or thereabouts. 4. That more than the 200 shares of authorized stock were issued. 5. That on April 17, 1953 or thereabouts you prepared papers for an agreement between Malakoff and Charles Kanter whereby you consented to have issued shares of stock of Nazareth Corp. in exchange of stock of Ambassador Estates Inc. Twenty shares of stock of Nazareth Corp. were issued for a sum of $12,000. and it also appears that Kanter also received dividends from Malakoff on said shares.

There are numerous other items that must be gone into and questions answered without any delay.

Demand is hereby made upon you as attorney and Director of the Corporation to send me full details as to the items herein above enumerated. It appears evident that

you are or should be familiar with all the facts especially since the corporate books were always in your possession and were released only several days ago for my inspection.

Very truly yours,

/s/ Benjamin Margolis
Benjamin Margolis

CC John Malakoff
280 Madison Ave.
New York, N. Y.

[fol. 19597]

Saul, General: Debtor's Exhibit P

June 2, 1953

Richard S. Hull, Esq.
393 Seventh Ave.
New York, N. Y.

Re: Nazareth Fair Grounds & Farmers' Market Inc.

Dear Sir:

Regarding the outstanding certificates of stock issued by John, I am enclosing herewith the list as taken from the stock book on Monday June 1st. 1953. The notations that appear on the stubs are also set forth on the list.

According to the records there are outstanding at this time a total number of 307 shares. Please be good enough to check this list and let me hear from you within the next few days as to whether there are any errors; also the number of shares that John has been able to get back up to the present time. No doubt, it would also be advisable to send me a revised list so that same is in my possession no later than Saturday morning so that the list can be used at the meeting that has been called for Monday, June 8th. 1953 at 5 P. M.

The stock transfer book has been left at John's office, therefore I would suggest that the names and addresses of

every stockholder together with the required information as to the date when the stocks were issued, whether it was an original issue or not, be entered in the book in compliance with law.

In going over the minute book I note that you wrote up the minutes of a so-called meeting that was held on July 2nd. 1952 by the Directors and Officers of Nazareth Fair Grounds & Farmers' Market Inc. also a meeting alleged to have been held on October 22nd. 1952, which latter meeting mentions about the assignment by the corporation to John Malakoff of a certain sum of $11,811.78. The two meetings mentioned herein were written up by you within the last few days. The fact remains, from the conversation had with Mr. Fried, he was not present at any such meetings and that the only meetings he attended were those originally set forth in the minute book. The fact that minutes are prepared at this late date in order to cover up certain items or have self-service is something that may not be acceptable to the present stockholders.

[fol. 10598] It is most urgent that you send me the information requested herein in writing.

It is my purpose to work along in a friendly spirit and cooperate provided the same spirit and cooperation be shown by you.

Very truly yours,

BENJAMIN MARGOLIS

H.
ENCL.

[fol. 10599]

SAUL, GENERAL: DEBTOR'S EXHIBIT Q

WHEREAS, the undersigned, as President and in control of the NAZARETH FAIRGROUNDS & FARMERS MARKET, INC. caused to be issued certain stock as security for personal loans made by various individuals to me personally, and,

WHEREAS, as a result of giving stock as security and issuing other shares I was advised thereafter that more

than the two hundred shares of the authorized stock was issued after counting all the shares outstanding including those that I gave as security for personal loans, and,

WHEREAS, a committee was formed to call a meeting of the stockholders to look into the affairs of the said corporation, and,

WHEREAS, I resigned as President and Director of the said corporation acting upon the request of the stockholders committee, and,

WHEREAS, there are certain obligations due me from the NAZARETH FAIRGROUNDS & FARMERS MARKET, INC. amounting to approximately $63,000. or thereabouts according to my personal records, and,

WHEREAS, it is my intention and purpose to satisfy the stockholders so as to not jeopardize their interests and rights if any,

NOW, therefore, in consideration of One Dollar and other good and valuable consideration to me in hand paid by the stockholders committee, receipt whereof is hereby acknowledged,

THE UNDERSIGNED, hereby agrees as follows:

1. That I hereby release and cancel any and all claims that I have against the NAZARETH FAIRGROUNDS & FARMERS MARKET, INC. by virtue of my services rendered in the amount of $63,000. or thereabouts, it being understood, however, that after the report of the stockholders committee be completed and it be determined that I am entitled to all or part of the sum hereinabove mentioned, that said sum or sums will be returned to me or stock of the corporation issued therefor.

2. It is further agreed that I will be given a copy of the report or reports that will be made by the firm of certified accountants in Pennsylvania, and the report of the attorney's in Pennsylvania, and also be apprised of any and all further reports that may come into the possession of the

stockholders committee or of the new Board of Directors that were recently elected.

Dated, New York, July 2, 1953.

/s/ JOHN MALAKOFF

[fol. 10600]

J. FRIED CREDITOR: EXAMINER'S EXHIBIT I

ASSIGNMENT OF LEASE

KNOW ALL MEN BY THESE PRESENTS, that I, JOSEPH SHERMAN, of the Borough of Nazareth, County of Northampton and State of Pennsylvania, for and in consideration of One Dollar ($1.00) to me duly paid by NAZARETH ENTERPRISES, INC., of the Township of Lower Nazareth, County and State aforesaid, have sold, and do hereby assign, transfer and set over unto Nazareth Enterprises, Inc., a certain Lease, dated the 11th day of August, 1953, made by Nazareth Fairgrounds and Farmers Market, Inc., to Joseph Sherman of premises located in Lower Nazareth Township, County and State aforesaid. To have and to hold the same unto Nazareth Enterprises, Inc., and its successors from the 28th day of April, 1953, for and during all the rest and remainder yet to come of, and in the term of years mentioned in the said Lease together with any renewals thereof, subject to the rents, covenants and conditions contained in said lease.

IN WITNESS WHEREOF I have hereunto set my hand and seal this 28th day of April, 1953.

/s/ JOSEPH SHERMAN (SEAL)
Joseph Sherman

[fol. 10601]

J. Fried Creditor: Examiner's Exhibit K

January 24, 1955.

Re: Nazareth Fair Grounds
& Farmers Market, Inc.

Nazareth Enterprises, Inc.
Fair Grounds
Nazareth, Penn.

Gentlemen:

You have been notified and are aware that Nazareth Fair Grounds & Farmers Market, Inc. is a bankrupt under Chapter X and duly filed a Chapter X proceeding which was approved in the United States District Court for the Southern District of New York.

You were also advised previously, orally, that the lease executed by Nazareth Fair Grounds & Farmers Market, Inc., dated the 18th day of August, 1952 to Joseph Sherman and which was thereafter assigned to yourself on April 28, 1953, was opposed by the present Debtor and Debtor in Possession on various grounds. Substantially, same are as follows:

1. That Jerome Fried is an officer of Nazareth Fair Grounds & Farmers Market, Inc., originally executed the Sherman lease on August 18, 1952 and while an officer thereof, took an assignment thereof in the name of Nazareth Enterprises, Inc., during which time the said Jerome Fried was an officer of both Nazareth Fair Grounds and Farmers Market, Inc. and Nazareth Enterprises, Inc.

2. That said lease is burdensome and oppressive to the Debtor in Possession by virtue of the terms thereof.

3. That the Debtor in Possession rejects said lease, pursuant to the provisions of the Chapter X of the Bankruptcy Act and the Bankruptcy acts relating thereto.

Very truly yours,

Alex L. Rosen

ALR:C

[fol. 10602]

J. FRIED, CREDITOR: EXTRACTS FROM DEBTOR'S EXHIBIT AI

READ THE CONDITIONS OF THIS LEASE

THIS LEASE, Made the 6th day of January A. D. 1958 Between Nazareth Fairgrounds & Farmers Market, Inc., Debtor hereinafter designated lessor, party of the First Part, and NAZARETH ENTERPRISES, INC., a Pennsylvania corporation hereinafter designated lessee, party of the Second Part.

1. WITNESSETH, that lessor doth hereby lease unto lessee all those certain premises, with the appurtenances, situated at the intersection of Routes 12 and 45 known as Nazareth Fairgrounds, Nazareth, Pennsylvania, and described as follows, viz: the race track, grandstand, parking area and the buildings and installations located thereon for the purpose of preparing and furnishing food and refreshments and the furnishing of toilet facilities to race patrons

To be used for the conduct of automobile races and public events and entertainment on Sundays and Fridays and on Decoration Day, Independence Day and Labor Day, or the nights preceding said Holidays, access to the premises be-
during all times
ing granted to the Lessee for the purpose of making repairs, improvements and making arrangements for the conduct of its business.

2. TO HAVE AND TO HOLD the same unto lessee for the term commencing the 1st day of March 1958, and ending the 1st day of November 1963

3. IN CONSIDERATION whereof lessee agrees to pay to lessor a sum equal to Fifteen Per Cent (15%) of the
spectator admission
Lessee's gross ~~receipts~~ from the use of the premises within two (2) weeks from the conduct of any race or event on the demised premises for which an admission charge is made by the Lessee.

4. Lessee may renew this lease on the same terms and conditions for a further period of Five (5) years by giving to the Lessor at least 90 days notice thereof by registered mail.

4A. The Lessor may cancel the renewed portion of the term in the event of a sale of all of the land and buildings of which the demised premises form a part by giving 30 days notice thereof to the Lessee by registered mail. Such cancellation shall be effective as of the close of the next succeeding automobile racing season which, it is understood, extends from April 1st to November 1st in each year. In the event of cancellation by the Lessor, the Lessee shall be entitled to receive from the Lessor on the effective date thereof a sum equal to the cost of all improvements made to the demised premises by the Lessee during the term hereof less depreciation thereon, provided however, such improvement were originally made with the written consent of the Lessor.

4B. Lessee shall maintain, for itself and Lessor, insurance policies insuring both parties against liability for accidents causing personal injuries or property damage as a consequence of the operation of Lessee's business with limits of at least $100,000 to $300,000.

(See attached Rider)

RIDER

4C. The Lessor being in reorganization under the Bankruptcy Act, this lease shall not become effective until the same shall have been improved by the United States District Court, Southern District of New York, or any duly authorized or competent officer thereof. Lessor agrees to apply for such approval without undue delay.

4D. Upon approval of this lease as aforesaid, all prior leases or agreements between the parties affecting the demised premises shall become null and void.

* * * * * * *

[fol. 10603]

NAZARETH FAIRGROUNDS & FARMERS MARKET, INC., Debtor.

By: .....(SEAL)

NAZARETH ENTERPRISES, INC. (SEAL)

By: /s/ JEROME FRIED, Pres. (SEAL)

[fol. 10604]

J. Fried Creditor: Margolis's Exhibit C

Enterprises Lease

(held by Nazareth Enterprises, Inc., as assignee of Lessee)

This Lease, made the 18th day of August, 1953 Between Nazareth Fairgrounds and Farmers Market, Inc., hereinafter designated Lessor, party of the First Part and Joseph Sherman hereinafter designated Lessee, Party of the Second Part.

1. Witnesseth, that Lessor doth hereby lease unto Lessee all those certain premises, with the appurtenances, situated in Lower Nazareth Township, County of Northampton and State of Pennsylvania, known as Nazareth Fairgrounds and Farmers Market, Inc., to be use in the sponsorship of carnivals, rodeos, races, all kinds of sporting events and entertainment features.

2. To have and to hold the same unto Lessee for the term commencing the 19th day of August, 1952 and ending the 30th day of November, 1962.

[fol. 10605] 3. In consideration whereof Lessee agrees to pay to Lessor the sum of Twelve (12%) percent of the gross admissions in the features set forth in Paragraph 1. However, on those days that the Lessee operates the food concessions for the events set forth in Paragraph 1, he shall pay to Lessor Fifteen (15%) percent of the gross admissions.

4. A lawful continuance of the tenancy beyond said term shall be deemed a renewal therefor for the further term of ten (10) years to end at the expiration thereof without further notice. And every further lawful continuance shall be deemed a further renewal for a like term, to end in like manner. And every such renewal shall be subject to the provisions of this lease.

5. Lessee will keep the premises in as good repair and condition as at the commencement of this Lease; and at the

end of said term or any renewal the Lessee will deliver up said premises without further notice in as good repair and condition as at the commencement hereof, ordinary wear and tear and unavoidable damage by the elements excepted.

6. Lessor agrees to make all major repairs.

7. Lessee agrees to keep premises in a clean and sanitary condition.

8. Lessee shall comply with all rules and regulations of State and Local Boards of Health.

9. Lessee agrees that no unlawful business shall be carried on upon said premises.

10. Lessee agrees to carry spectators' liability insurance for all events promoted by him.

11. Lessee may assign this lease under the same terms and conditions set forth herein without Lessor's consent.

[fol. 10606] 12. The heirs, executors, administrators and successors of said parties respectively are included herein as if in each instance specifically mentioned.

NAZARETH FAIRGROUNDS AND FARMERS MARKET, INC.

By /s/ JEROME FRIED (SEAL)
General Manager

/s/ JOSEPH SHERMAN (SEAL)
Joseph Sherman

Signed and delivered the day and year first written in the presence of:

/s/ LORENA UHLER

[fol. 10607]

KATZENELL EXHIBIT 6

26

No. ..... NEW YORK Sept. 4 1954

1-8
210

THE NATIONAL CITY BANK OF NEW YORK
CITY BANK FARMERS BRANCH
Twenty-two William Street at Exchange Place
New York, N. Y.

PAY TO THE ORDER OF John Malakoff, Agt $2000.00

Two Thousand 00/100 DOLLARS

/s/ KATZENELL

Frederick Katzenell
650 Fifth Avenue
New York 19, N. Y.

[fol. 10608]

(Endorsements on back)

Re—Nazareth Inc.
Total 30000

John Malakoff
~~Hotel Wales~~
Loan

John Malakoff, Agt

(Stamp)

Pay to the Order of any
Bank, Banker, Trust Company
or through the
New York Clearing House

Sep 6 '51 1109

Prior Endorsements Guaranteed

Corn Exchange Bank Trust Co.
1-45 of New York 1-45

KATZENELL EXHIBIT 7

John Malakoff — 1950

Date		Amt		Date	received		Cap. Int	Gain	
Feb 2	John Malakoff Bond	1000.00		April 18	450.		1000.	450.00	77th Stock
" 2	" " ✓	2750.00		" 21	2375.		625.	750.00	
" 23	" " (B. Mangolen) ✓	1125.00		May 5	875.		875.00		no profit
Mar 3	" " ✓	175.00		Jul 15	3250.		2750.00	500.	
April 5	" " ✓	937.50	937.50	Aug 18	343.00			343.00	
" 14	" " ✓	625.00		Sept 18	1300.		1300.		no profit
" 20	" " (M. Steinberg) ✓	875.00		Oct 13	2700.00		2700.		no profit
May 11	" " ✓	1875.00		Nov 9	1000.		875.	125.00	
" 12	" " (Miss Killen) ✓	8000.00	+ 6000 -	" 21	2250.		1875.	375.00	
Jun 29	J.K. (Mangolen) ✓	2500.00	2500 ?	Dec 7	Killen	2100	Mer 2000.	100.00	ab. Check
Jul 7	John Malakoff ✓	23.00		Dec 15				153.00	
Aug 18	" " ✓	2700.00						2643.00	Profit
Sept 19	" " ✓	150.00							
" 19	" " Carl	2000.00	2000 -						
Dec 8	" "	5000.00	5000 -						
Dec 14	" " (S Rosenwald)	2825.00	2825 -						
" 20 ✓	" " (Steinberg)	1000.00	1000 -						
		34137.50							
			19350.00						
			937.50						
	+ to be applied 1951		20287.50						

6/29 Flora Kroger — Total 3143.00 Profit

(KATZENELL - 5)

1951 = John Malakoff

	balance carried (1950)		20,287.50	
Jan 10	J. M. (Mangolen)		2500.00	✓
" 24	" "	4250 + 750	5000.00	
Feb 7	" "		2300.00	
" 9	" "		2000.00	
April 4	" " (Campbell)		2100.00	✓
" 6	" "		416.00	✓
" 17	" " Morgenthau		1250.00	✓
May 10	" "		2500.00	
" 15	" "		2500.00	
" 17	" " (Helen) Loan		5000.00	
" 23	" "		250.00	
" 23	" "		1750.00	
Jun 1	" " (Steinberg)		1666.66	✓
" 6	" "	20 BE's	500.00	✓
" 6	" " Chestnut Pl. Co.		500.00	✓
" 8	" "		645.00	
" 12	" " (Campbell)		1500.00	
" 19	" "		1000.00	
" 19	" " cash		500.00	
" 19	" "		200.00	
July 2	" " Morgenthau		500.00	✓
" 2	" "		800.00	
" 2	" " cash		1100.00	
" 12	" "		2000.00	
" 12	" "		1150.00	✓
			40,557.66	

John Malakoff

			40,557.66	
Jul 12	J. M. (Steinberg)	39.63	500.00	
" 12	" " Morgenthau		250.00	
Aug 29	" "		1100.00	
Sept 4	" "		2000.00	
			44,407.66	
	1150 + 750 = 1900			
	40,557.66			
	Received 1951			
April 17	Cash		1300.	✓
" 26	"		1666.66	✓
" 26	"		1250.00	✓
May 5	"		1750.00	✓
Jun 18	"		300.00	
July 3	"		325.00	
" 7	Profit	150.00		
")			1660.00	
" 8	"	800.00		
"		337.50	1550.	
Sept	Cash	11.37	1348.	✓
"			1609.00	
			12,078.66	

(Received cash Sept [illegible] Profit on Sale of Bonds)

[fol. 10611]

MASUR EXHIBIT 8

JOHN MALAKOFF
REAL ESTATE
280 MADISON AVENUE—SUITE 403
NEW YORK 16, N. Y.

LEXINGTON 2-3281-2

September 11, 1951

Mr. Harold Qu. Masur
522 East 20th Street
New York City

Dear Sir:

Please be advised that I am holding in escrow the sum of Four thousand dollars which represents one-fiftieth (1/50th) ownership in the Nazareth Farmer's & Auction Market, in Nazareth, Pennsylvania.

At the present time the return on your investment is twenty per cent (20%) per annum, payable monthly. As the net income increases your return will increase proportionately.

Thank you.

Yours very truly,

/s/ JOHN MALAKOFF
John Malakoff

[fol. 10612]

T. SCHWARTZ EXHIBIT 5

JOHN MALAKOFF
REAL ESTATE
280 MADISON AVENUE—SUITE 403
NEW YORK 16, N. Y.

LEXINGTON 2-3281-2

March 20, 1953

Mr. Harold B. Schwartz
260 West End Avenue
New York City

My dear Mr. Schwartz:

Thank you very much for forwarding the check in the sum of $3,000. for three shares in the Nazareth Fair Grounds & Farmers' Market, for your sister Tess J. Schwartz.

Enclosed herewith please find stock certificate. As per your instructions, I will forward her check to you at the above address, each month.

Thanking you for the opportunity you have given me to serve you, I am,

Yours very truly,

/s/ JOHN MALAKOFF
John Malakoff

JM:eb
Enc.

[fol. 10613]

TREAT EXHIBIT 4

John Malakoff
(Letterhead)

September 11, 1951

Mr. Larry Treat
Baptist Church Rd.
Yorktown Heights, New York

Dear Sir:

This is to acknowledge receipt of your check in the sum of Two thousand dollars ($2,000) which I am holding in escrow, for 2/200ths of The Nazareth Farmer's & Auction Market, Nazareth, Pennsylvania.

The return of the above investment is now twenty per cent per annum payable monthly. As the income increases the return on your investment will increase proportionately.

Thank you.

Yours very truly,

JOHN MALAKOFF

hb

[fol. 10614]

B. CLARK EXHIBIT 5

JOHN MALAKOFF
REAL ESTATE
280 MADISON AVENUE—SUITE 403
NEW YORK 16, N. Y.

LEXINGTON 2-3281-2

August 1, 1951

Mr. Barry Clark
200 West 90th St.
New York City

Dear Sir:

Please be advised that we are holding in escrow the sum of $4,000. which you have invested with me in the deal in Nazareth, Penna., known as The Nazareth Farmer's & Auction Market. Your investment represents four (4) shares of stock in this transaction which you in turn will hold in escrow until the deal is consummated.

At the present time the return on your investment is 20% per annum payable monthly. As the amount of net income increases, your return will increase proportionately.

Thank you.

Yours very truly,

/s/ JOHN MALAKOFF
John Malakoff

[fol. 10615]

REMOVAL: WOLF'S EXHIBIT 25

To: JEROME FRIED
Haupt Street & Eichlin Road
Easton, Pa.

Receipt is acknowledged of your check for $2,200.00 to re-imburse me for the purchase for your account on March 2 and March 3, 1959 of 2 shares of stock held by Dorothy Clark, 4 shares of stock held by Barry Clark, and 2 shares of stock held by Lazar Karapontso in Nazareth Fairgrounds & Farmers Market, Inc.

I acknowledge to you that I have no interest in any of said shares and that in connection with the memoranda of March 2 and March 3, 1959 covering this purchase which were signed by the sellers, I was acting as your agent.

Delivered to you herewith are originals and original copies of the memoranda of March 2 and March 3, 1959, together with receipts for the balance of the purchase price, for filing in the Chapter 10 proceeding in the United States District Court, Southern District of New York, in the matter of Nazareth Fairgrounds & Farmers Market, Inc.

April 22nd, 1959.

/s/ ARNOLD A. WEINSTEIN

Receipt is acknowledged of the memoranda and receipts referred to above.

April 22nd, 1959

.....

[fol. 10616]

REMOVAL: WOLF'S EXHIBIT 44

Extract from Lease dated December 29, 1956, between Nazareth Fair Grounds & Farmers' Market, Inc. and J&J Foods Inc.

* * * * * * *

4. [Rent:]

(a) The sum of $6,000 per year, or 15% of the first $1,000 gross sales per week and 10% of the gross weekly sales in excess of the said first $1,000, or whichever amount is the greater, payable at the end of each and every week.

* * * * * * *

[fol. 10617] 19. The lessor agrees that it will not, during the term hereof, enter into a lease for any space at the Nazareth Fair Grounds and Farmers' Market with any person, firm or corporation for the sale and consumption on the premises of food, such as frankfurters, hamburgers, hot food platters, ice cream, desserts, non-alcoholic liquid refreshments, and kindred items, or for the sale of baked goods baked on the premises. * * *

* * * * * * *

24. This lease shall be operative on only two (2) days of each and every week during the term hereof and, until further notice, such days shall be Wednesday and Saturday.

25. This lease supersedes all previous agreements between the parties, if any, covering business locations at the

premises of the Nazareth Fair Grounds and Farmers' Market, Inc., in Nazareth, Pennsylvania.

* * * * * * *

NAZARETH FAIR GROUNDS AND FARMERS' MARKET, INC.

By /s/ ARNOLD A. WEINSTEIN
Arnold A. Weinstein

J&J FOODS, INC.

By /s/ JAMES LAGROTTE
James LaGrotte

[fol. 10618]

IN UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 403—October Term, 1960.

Argued August 17, 1961

Docket No. 26362

In the Matter

of

NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., Debtor,
ARNOLD A. WEINSTEIN and JEROME FRIED, Appellants,

—v.—

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL, FREDERICK KATZENELL, and NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., Appellees.

Before: MOORE, FRIENDLY and SMITH, *Circuit Judges*.

Weinstein, president of the debtor, and Fried, its general manager, appeal from so much of an order of the District Court for the Southern District of New York, Sidney Sugarman, *J.*, as prohibited Weinstein from having anything further to do with the operation of its business and discharged Fried from its employ, approved the [fol. 10619] election of one Philip as director and treasurer, prohibited disbursal of funds except on Philip's countersignature, and authorized Philip to supervise the debtor's affairs pending employment of a new general manager. Wolf and other stockholders cross-appeal from so much of the order as failed to order Weinstein and Fried to reimburse compensation and expense moneys already received. Reversed on Weinstein's and Fried's appeal save for approval of election of directors and officers; affirmed on cross-appeal.

Harold Harper (Harper & Matthews) (Harold Harper and Vincent P. Uihlein, on brief), New York, New York, for appellant Jerome Fried.

Arnold A. Weinstein, New York, New York, attorney pro se.

Alex L. Rosen, New York, New York, for Debtor.

Melvin L. Robbins, New York, New York, for appellees Wolf, Davidson, Hull and Katzenell.

OPINION—November 9, 1961

FRIENDLY, *Circuit Judge*:

The skeins from which Nazareth Fairgrounds & Farmers' Market, Inc. (hereafter Nazareth) began, and the lengthy efforts to unravel them, are recounted in my brother Moore's opinion in Nos. 27000 and 26962, this day decided. The instant appeals relate to a chapter in the Nazareth epic which, if scarcely modern, is at least more recent. The principal issue is the applicability to an officer and to a

general manager of a debtor in possession, who have been [fol. 10620] receiving compensation pursuant to §191 of the Bankruptcy Act, of Section 249, which provides:

> "Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge been otherwise acquired or transferred."

We hold the section inapplicable.

Nazareth filed its petition for reorganization under Chapter X in September, 1953. Weinstein was then its president and Fried general manager.[1] The petition prayed that the "petitioner by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of your petitioner." The Court left the debtor in possession and authorized it to pay $100 a week to Fried, then described as secretary-treasurer, and nothing to Weinstein. Later the salary of Fried, then described as general manager, was increased, first to $150 and then to $200 a week, and Weinstein was awarded compensation of $50 a week. Fried, who is located [fol. 10621] at Nazareth, Pa., has been in active charge of the day-to-day operations of the debtor; Weinstein, a New York attorney, has made regular inspection trips and has

[1] Fried had previously been a director and secretary-treasurer; he resigned these offices on June 29, 1953.

passed on leases and other general policy matters. The administration has been successful, gross business having tripled from 1953 to 1959 and profits having risen from zero to $41,269.

In the course of administration a bitter contest for control arose between the stockholders who had elected Weinstein and Fried and an opposition group with which appellees are identified, known as the Rehrig group, Rehrig being a tenant of the debtor. In August, 1958, an election of directors was held, at which Weinstein, Herbert Danciger (not in either group), and Philip (Rehrig's attorney) were elected; they thereupon chose Weinstein as President, one Laupheimer as Vice President, Danciger as Secretary, and Philip as Treasurer. All this was subject to the Court's approval, as required by §191; among the welter of petitions in this proceeding was one, verified August 6, 1958, but not decided until June 14, 1960, asking for that.

In March, 1959, appellees submitted a "Petition for Termination and Recoupment of Compensation (Pursuant to §249 of the Bankruptcy Act)." The petition alleged that Weinstein's sister had purchased six shares of the debtor's stock in 1957; that in 1958 and 1959 Weinstein had purchased three shares and sold a fraction of one; that in 1959 he or persons represented by him had exercised options to purchase six shares; that Fried had bought twenty shares in 1957 of which he had sold ten back to the vendor in 1958; and that these transactions violated §249 and required the termination of appellants' compensation and the return of salary and expense moneys previously received. Weinstein filed an answering affidavit disclaiming responsibility for his sister's purchase and [fol. 10622] taking the position that his own purchases were made from stockholders who had tired of the long delays and insisted on selling to someone despite Weinstein's advice that they keep their stock—also that as to most of the stock, he was buying pursuant to options which had been arranged, in order to prevent a "raid" by Rehrig, on a basis that might result in others participating in the purchase nominally being made by him. He alleged also "that until

now I was not aware of section 249 of the Bankruptcy Act." although conceding that he was "chargeable with knowledge of its provisions." This was followed, a month later, by an order requiring appellees to show cause why their petition should not be dismissed pursuant to F. R. Civ. Proc. 12(b), with leave to appellants to answer in the event of denial.

The Court sent the matter to a referee for hearing and report; Referee Joyce recommended that the motion to dismiss be granted. When his report came before the District Judge in January, 1960, the judge filed a memorandum disapproving the Referee's ruling and setting a hearing for proof bearing on "recoupment" of past compensation and expense moneys. Such a hearing was held on June 14; at its conclusion, the judge directed from the bench that Fried be discharged as general manager, that Weinstein have nothing further to do with the operation of debtor's business, that the prayer for "recoupment" be denied, that the election of directors and officers be approved, that no funds should be disbursed save on Philip's countersignature, and that Philip should supervise the debtor's affairs pending the early appointment of a new general manager.[2] Weinstein and Fried appealed from all of the order save for the denial of "recoupment" and so much of the approval of the election as did not relate to Philip; appellees cross-appealed from the former. On motion of Weinstein and Fried, offering to serve without compensation unless the order should be reversed, this [fol. 10623] Court, on July 12, 1960, stayed so much of the order as removed them from participation in the debtor's affairs and designated Philip in their stead, with leave to the District Judge to file more detailed findings of fact and conclusions of law. These make plain that "Weinstein's and Fried's dissociation from the management" of the debtor was directed "solely because they, as fiduciaries, violated section 249 of the Bankruptcy Act by dealing in the debtor's stock." When granting the stay, we had supposed the ap-

[2] The judge had previously said orally at the hearing on June 14, 1960, that "in view of the Court's disposition of the petition for termination of compensation to Messrs. Weinstein and Fried, they can no longer function in their respective offices * * *."

peals would be heard in the fall of 1960; however, they were not argued until a special sitting on August 17, 1961. On Weinstein's and Fried's appeal we reverse, save as to the approval of the election of directors and officers; this reversal leads to affirmance on the cross-appeal.

We assume that, under the wide powers conferred by §188 of the Bankruptcy Act, the District Court might permissibly conclude that an officer or employee of a debtor who had disentitled himself to receive compensation should no longer be allowed to serve even if his service was otherwise in the best interests of the estate. The question thus is whether appellants had done that.

Section 249 finds its source in two district court decisions, *In re Paramount-Publix Corp.*, 12 F. Supp. 823 (S. D. N. Y. 1935), and *In re Republic Gas Corp.*, 35 F. Supp. 300 (S. D. N. Y. 1936), denying compensation to members of committees who had traded in securities of a debtor in reorganization under §77B of the Bankruptcy Act, 48 Stat. 912 (1934), the predecessor of Chapter X, see also *In re Mountain States Power Co.*, 118 F. 2d 405, 407 (3 Cir. 1941). Referring to these cases, the draftsmen of the Chandler Act explained that §249 was "a develop-[fol. 10624] ment of the idea that fiduciaries who trade in the securities should be penalized; that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law" and constituted "a step toward the codification" of the rule laid down in the district court decisions, "an attempt to make it more uniform," and "broaden the base a little bit."[6] Decision whether the base was broadened so as to include an officer and a supervisory employee of a debtor in possession demands some examination of the latter concept and of the structure of the statute. Here, as in *Duparquet Huot & Moneuse Co. v. Evans*, 297 U. S. 216, 218 (1936), "there is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts."

[6] 75th Cong. 1st Sess., Hearings before the Committee on the Judiciary of the House of Representatives on H. R. 6439, pp. 183-184.

The concept of leaving of a debtor in possession, "A receivership without a receiver,"[4] was one of the many innovations introduced by §77B to meet the insolvency problems of the great depression. The thought was that expense could be saved and perhaps efficiency gained by avoiding the universal appointment of trustees and continuing, in appropriate cases, the possession of corporate managements whose calamities, in many instances, had been due to national or even international economic forces quite beyond their control. After much debate, this practice was carried into Chapter X, in considerably reduced scope. The provisions dealing with it are found in Article VII—Proceedings Subsequent to Approval of Petition, §§156, 159, 162, 163, 168, and 170, and in Article VIII—Title, Rights, and Powers of Trustees and Debtors in Posses-[fol. 10625] sion, especially §§188, 189, 190 and 191. The first sentence of §191 provides "A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court." The orders with respect to Weinstein's employment were made pursuant to that section, and the orders with respect to Fried were evidently intended to be.

On the other hand, §249 is contained in Article XIII, entitled "Compensation and Allowances." The initial sections, 241-246, describe the persons to whom reimbursement for costs and expenses and compensation for services rendered may be made. These include the referee, special masters, "the trustee and other officers" and their attorneys, the attorney for the debtor, the attorney for the petitioning creditors, indenture trustees, depositaries, reorganization managers, committees or representatives of creditors or stockholders, and certain other categories. Section 247 provides that "The judge shall fix a time of hearing for the consideration of applications for allowances," notice of which shall be given to a wide variety of parties

[4] Judge (then SEC Commissioner) Frank, 75th Cong. 2d Sess., Hearings before the Committee on the Judiciary of the Senate on H. R. 8046, p. 99, quoted in 6 Collier, Bankruptcy (14th ed. 1956), p. 1994, fn. 3.

in interest. After an intervening section not here relevant, comes §249, quoted above.

If the words in the final sentence of §249 "or other person acting in the proceedings in a representative or fiduciary capacity" were to be read in isolation and out of context, appellees would doubtless be right that Weinstein and Fried fell within them. However, as said in *United States* v. *American Trucking Ass'ns, Inc.*, 310 U. S. 534, 542 (1940), "To take a few words from their context and with them thus isolated to attempt to determine their meaning, certainly would not contribute greatly to the discovery of the purpose of the draftsmen of a statute." The last sentence of §249 must be read not only with the preceding one but with the other sections of Article XIII. When the sentence is so read, it becomes fairly plain that the words "or [fol. 10626] other person acting in the proceedings in a representative or fiduciary capacity" relate only to persons so acting who fall within the categories allowed compensation under §§241, 242 or 243.

Officers of a debtor in possession are not among these. They are not "other officers" within §241(3), at least if that term has the meaning specified in §1(22), and we see no reason why it should not, since the defined meaning is not "inconsistent with the context." Nowhere do §§241, 242 and 243 refer to officers or employees of the debtor, an omission doubly significant in view of the specific mention of the attorney for the debtor in §241(4). The reason for the omission is plain enough. Such persons were not required to "seek compensation" through the necessarily cumbersome procedure of §247, since compensation of officers of the debtor would have been approved under §191 and employees would have been paid, under §189, as if the debtor had remained solvent. Not being required to seek compensation under §247, they have not been subjected to §249, and the order of removal cannot survive the fall of its underpinning.[5]

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[5] Reversal of the order of removal carries with it so much of the order as authorized Philip to supervise the debtor's affairs pending approval of a general manager to replace Fried.

Such a construction accords with the sense of the statute. The persons to whom Article XIII authorizes the allowance of compensation for services from the estate of the debtor are persons who would not have been rendering such services if the reorganization proceeding had not occurred. For these strangers the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from consensual arrangements, subject only, in the case of officers, to judicial approval under §191. It would be altogether natural for Con- [fol. 10627] gress to prescribe that persons of the former sort, when acting in a representative or fiduciary capacity, should abstain from dealing in claims against or stock of the debtor on pain of forfeiting any right to compensation, without imposing similar Draconian penalty upon the latter, who were being compensated during the Chapter X proceeding for the same executive services they had rendered before. At the very least, courts are justified in demanding a clear indication of Congressional purpose before inflicting what we have recognized as so harsh a forfeiture, *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F. 2d 862, 868 (2 Cir. 1959), cert. denied, 361 U. S. 862 (1959), upon persons who, despite their fiduciary obligations, had been free to buy or sell stock of the corporation before the Chapter 7 proceeding was contemplated, *SEC* v. *Chenery Corp.*, 318 U. S. 80, 88 (1943); *Manufacturers Trust Co.* v. *Becker*, 338 U. S. 304, 312-314 (1949), and would expect to remain with it thereafter.

If it be contended against this that the president and the general manager of a debtor in possession bear essentially the same relation to creditors and stockholders and have the same access to inside information as a trustee, and that since §249 applies to the latter, it must therefore apply to the former, there are several answers—apart from the sufficient one that this is not what the words say. One is that in a closely related respect Chapter X clearly distinguishes between what is demanded of a trustee and what is expected of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional

trustee whom the judge may appoint "to operate the business and manage the property of the debtor") must be "disinterested," which, under §158(1), he is not if "he is a creditor or stockholder of the debtor." No such requirement was or practically could be imposed on officers of the debtor; instead, for that very reason, §168 authorizes the [fol. 10628] judge to "appoint a disinterested person as examiner to prepare and file a plan" and to perform the investigative duties imposed upon the trustee by §167(1) to (5). Also the argument under consideration proves too much. A salaried employee of the trustee entrusted with general supervision of the debtor's affairs, whether or not an officer of the debtor employed under §191, would have the same access to inside information as the president or general manager of a debtor in possession; yet one would have to press hard, indeed, to read §249 as including him.

Our ruling that §249 is inapplicable to an officer or supervisory employee of a debtor in possession in no way entails as a consequence that a bankruptcy court is helpless to deal with breaches of fiduciary obligation on his part. This Court has held, in the case of a person clearly within §249, that failure to establish the purchase or sale that would trigger that section's denial of all compensation does not preclude or, indeed, relieve the court from taking account of related breaches of fiduciary obligation in fixing the amount, *Berger* v. *Equitable Office Building Corp.*, 175 F. 2d 218 (2 Cir. 1949). By the same token the court may consider, in an appropriate case, that a purchase or sale of stock by a person not within §249 requires reduction or even elimination of compensation from an estate under the court's supervision, or removal of such person from office. See *American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U. S. 138, 146-147 (1940); see also *In re Midland United Company*, 159 F. 2d 340 (3 Cir. 1947). The distinction is that such a ruling would rest upon an exercise of judicial discretion, taking appropriate account of all relevant circumstances, rather than on the automatic forfeiture which the judge here thought the statute required. Nor is this all. Despite a statement to the House Judiciary Committee that §249 was being presented in

[fol. 10629] lieu of a proposal "that if a person in a fiduciary capacity uses inside information to purchase or sell securities, then he shall be penalized,"[6] we cannot believe enactment of §249 curtailed the inherent power of bankruptcy courts to impose remedies of a totally different sort for breach of fiduciary obligations, such as scaling down claims to the amounts paid or requiring an accounting for profits, even for persons subject to §249 and surely for persons who are not, and again whether the final clause of §212 is or is not literally applicable.[7] Decisions under §77B providing for such a scale-down as against directors of a debtor in reorganization, *In re McCrory Stores Corp.*, 12 F. Supp. 267, 269 (S. D. N. Y. 1935), and *In re Philadelphia & Western Ry.*, 64 F. Supp. 738 (E. D. Pa. 1946), were noted with apparent approval in *Manufacturers Trust Co.* v. *Becker*, *supra*, at 314 fn. (1949); see also *In re Norcor Mfg. Co.*, 109 F. 2d 407, 411 (7 Cir. 1940) and *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77 (S. D. Cal. 1941). Cf. *Mosser* v. *Darrow*, 341 U. S. 267 (1951). Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees complain; indeed, the judge's denial of "recoupment" would indicate he did not regard their conduct as having been very iniquitous.

Appellants attack also the portions of the order approving Philip's election as a director and as treasurer and requiring his countersignature of checks; they assert that Philip's true allegiance is to Rehrig, who, they claim, is seeking to make a lease unfavorable to the debtor's interests.

[fol. 10630] The volume and character of the papers in this proceeding leave little doubt that directors' meetings attended by Weinstein and Philip are scarcely likely to set

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[6] *Supra* note 3.

[7] Section 212 permits the court, in the case of "an agent, attorney, indenture trustee, or committee," to "limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."

new records in pastoral harmony. However, Pennsylvania, where the debtor is incorporated, considers a minority's right to representation on a corporate board of directors so vital that it has enshrined cumulative voting in its Constitution, Art. XVI, §3—although both proponents and opponents of that system recognize that the presence of sharply conflicting interests among the directors may result. See Williams, Cumulative Voting for Directors (1951), c. X; Baker and Cary, Cases and Materials on Corporations (3d ed. unabridged 1959), pp. 209-210; Young, The Case for Cumulative Voting, 1950 Wis. L. Rev. 49, 53; Axley, The Case Against Cumulative Voting, 1950 Wis. L. Rev. 278, 279. Consistent and vigorous advocacy of policies honestly deemed by the majority to be seriously adverse to corporate interests would thus not be a ground for disqualifying a minority director in Pennsylvania, although a record of actual obstruction would be, *Markovitz* v. *Markovitz*, 336 Pa. 145, 8 A. 2d 46 (1939). To be sure, a court of bankruptcy is not bound to approve a director simply because he has been elected to represent a minority through cumulative voting, any more than it would be to approve one elected by a majority with or without such procedures. Still some weight ought be given to Pennsylvania's policy and, even apart from that, the stockholders' election of directors "will not be disturbed unless a clear case of abuse is made out" or it appears that judicial veto is required "to the end that the property may be safely and effectively managed." *In re J. P. Linahan, Inc.*, 111 F. 2d 590, 592 (2 Cir. 1940). As one of three directors Philip will have no power to force the making of a lease to Rehrig, and this presumably would require the court's approval in any event. There is nothing as yet to show that as a director, or as [fol. 10631] treasurer, Philip will obstruct the operation of the business in the private interest of the Rehrig group as distinguished from acting as its voice and ears; we read §188 as empowering the court to remove him if he should. On the other hand, the requirement of Philip's countersignature of all checks might well jeopardize the successful functioning of the business; indeed, it is not at all clear

that the judge meant this to continue beyond the appointment of a new general manager in place of Fried.

The order is therefore reversed save for its approval of the election of directors and officers, as to which it is affirmed.[8]

[fol. 10632]

IN UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Present: Hon. Leonard P. Moore, Hon. Henry J. Friendly, Hon. J. Joseph Smith, Circuit Judges.

In the Matter

of

NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., Debtor, ARNOLD A. WEINSTEIN and JEROME FRIED, Appellants,

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL, FREDERICK KATZENELL and NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., Appellees.

JUDGMENT—November 9, 1961

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court

[8] Nothing herein is to be deemed to preclude the judge from taking any further action with respect to directors or officers that he may find appropriate as a result of our decision in Docket Nos. 27000 and 26962.

be and it hereby is reversed save for its approval of the election of directors and officers; as to which it is affirmed in accordance with the opinion of this court; with costs to the appellants Arnold A. Weinstein and Jerome Fried.

A. Daniel Fusaro, Clerk.

[fol. 10633] [File endorsement omitted]

[fol. 10634] Petition for Rehearing covering 8 pages filed November 21, 1961 omitted from this print.

It was dgnied, and nothing more by order November 29, 1961.

[fol. 10635]

In United States Court of Appeals

For the Second Circuit

Present: Hon. Leonard P. Moore, Hon. Henry J. Friendly, Hon. J. Joseph Smith, Circuit Judges.

In the Matter

of

Nazareth Fair Grounds & Farmers' Market, Inc., Debtor, Arnold A. Weinstein and Jerome Friel, Appellants,

v.

Irving J. Wolf, Robert H. Davidson, Richard S. Hull, Frederick Katzenell, and Nazareth Fairgrounds & Farmers' Market, Inc., Appellees.

Order Denying Petition for Rehearing —November 29, 1961

A petition for a rehearing having been filed herein by counsel Irving J. Wolf, Robert H. Davidson, Richard S. Hull, and Frederick Katzenell,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. Daniel Fusaro, Clerk.

[fol. 10635a] [File endorsement omitted]

[fol. 10636] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 10637]

In United States Court of Appeals

For the Second Circuit

Nos. 415, 429—October Term, 1960.

Argued August 17, 1961

Docket Nos. 26962, 27000

Calendar No. 415

Docket No. 26962

Jerome Fried and Nazareth Fairgrounds & Farmers Market, Inc., Appellants,

—against—

Benjamin Margolis, Ida Mae Margolis, Sarah Kason, Bernard L. Ungar and William McK. Shongut, Appellees.

Calendar No. 429

Docket No. 27000

Arnold A. Weinstein, Jerome Fried and Irving J. Wolf, et al., Appellants,

—against—

Nazareth Fairgrounds & Farmers Market, Inc., et al., Appellees.

[fol. 10638] Before: Moore, Friendly and Smith, Circuit Judges.

Appeals in Docket No. 27000 from an order made on December 8, 1960 (Sugarman, *D.J.*) in a Chapter X, Bankruptcy Act, proceeding in the United States District Court for the Southern District of New York, resolving the stock interests in the Debtor of 36 claimants. Order reversed except as specified in opinion.

Appeals by the Debtor and J. Fried in Docket No. 26962 from an order made on April 10, 1961 (Sugarman, *D.J.*) in a Chapter X, Bankruptcy Act, proceeding in the United States District Court for the Southern District of New York, granting a petition to reopen proceedings in connection with petitions to review an order of a Referee in Bankruptcy made October 5, 1957, disallowing stock claims of 5 claimants and to receive in evidence in support of such petitions to review, the minutes of all hearings relating to the stock claimants in Docket No. 27000 and to take further testimony. Order affirmed as to reception of so much of the minutes as does not concern evidence peculiar to the claimants concerned in Docket No. 27000; otherwise reversed. On the petitions to review the order of the Referee in Bankruptcy, the district court is directed to modify the order of October 5, 1957, in accordance with this opinion.

Alex L. Rosen, New York City, for appellant-appellee Nazareth Fairgrounds & Farmers Market, Inc.

Harold Harper (Harper & Matthews, New York City, Vincent P. Uihlein, of counsel), for appellant Jerome Fried.

[fol. 10639] Armende Lesser, New York City, for appellee William McK. Shongut.

Arnold A. Weinstein, New York City, pro se.

Melvin Lloyd Robbins, New York City, for appellants Wolf et al.

Leonard Franklin, New York City, for appellees Herbert Danciger and Melvin S. Danciger.

OPINION—November 9, 1961

MOORE, *Circuit Judge*:

The two cases (Nos. 26962 and 27000) consolidated on this appeal both involve the resolution of stock claims in Nazareth Fairgrounds & Farmers Market, Inc. (the Debtor), a corporation being reorganized under Chapter X of the Bankruptcy Act. No. 26962 involves five stock claimants (54 shares) and is an appeal from an order of the District Court which reopened the proceedings on a petition to review a decision of the Referee denying the stock claims of the five claimants therein. No. 27000 is an appeal from an order of the District Court settling and allowing the stock claims of the thirty-six claimants (262 shares) therein.

The Debtor was organized on August 7, 1951, as part of a plan to transfer the ownership of a farmers' market in Nazareth, Pennsylvania, a parcel of some 32 acres and buildings, from a group consisting of Edward Malakoff, Maurice Malakoff, Milton Zoloth and Morris Soble (the Philadelphia Group) to John Malakoff (Malakoff). Previously thereto on April 17, 1951, the Philadelphia Group through a controlled corporation, Richard Realty Co., purchased this property from its then owner, Nazareth Fairgrounds, Inc., for $66,000. John Malakoff had one-quarter [fol. 10640] interest in the original purchase of the property by the Philadelphia Group. On May 14, 1951, for corporate and tax reasons Richard Realty Co. conveyed the property subject to mortgages to Kipling Realty Co. (also a Philadelphia Group controlled corporation) for $100.

In July, 1951, John Malakoff orally agreed (so found by Examiner and trial court) to purchase the Philadelphia Group's interest in the property for $63,000 plus an undetermined amount, alleged to have been $30,000. The Articles of Incorporation of the Debtor which were executed on August 1, 1951, provided for an authorized capital

of 200 shares with a stated capital applicable thereto of $120,000. The first meeting of the directors of the Debtor authorized the purchase of the Nazareth property from Zoloth and Soble for twenty shares of the corporation's stock and the assumption of all obligations by the corporation, including amounts shown as loans payable to the Philadelphia Group. About August 8, 1951, stock certificate #1 for 10 shares was issued to Milton Zoloth and certificate #2 for 10 shares was issued to Morris Soble. On October 17, 1951, a contract was executed between John Malakoff and Zoloth and Soble whereby Malakoff purchased their 20 shares of stock for $32,853.08; $2,853.08 was paid on execution of the contract and the remaining $30,000 was to be paid in 10 monthly installments of $3,000. Title to the stock was to pass on the execution of the contract but the stock was to be held in escrow until the payment of the $30,000. On October 17, 1951, Zoloth endorsed stock certificate #1 over to Malakoff and on October 22, 1951, Soble endorsed certificate #2 to Malakoff. On June 17, 1953, Malakoff endorsed these certificates over to the Debtor, and executed a release of all claims against the Debtor.

[fol. 10641] The certificates and corporate books were not turned over to Malakoff until December, 1952, although he had been managing the business since October, 1951.

In April, 1951, Malakoff started to solicit investments in the Nazareth enterprise, promising investors a 20% return on their capital. Generally, shares were offered at a rate of $1,000 a share, although some investors paid only $600 a share.

Between April 1, 1951, and February 15, 1952, Malakoff received from investors in the Nazareth venture $79,025 and paid to the Philadelphia Group $77,010.84; the latter figure includes $11,032.84 received in payment of an insurance claim for windstorm damage. However, at no time did the amount that John Malakoff paid to the Philadelphia Group exceed the amount which he had already collected from investors. Until he became insolvent in June, 1953, Malakoff paid monthly "dividends" to the investors based on a 20% annual return on their original

investments. These "dividends" were paid in Ponzi-like[1] manner out of new money received from investors in the Nazareth Market. The corporation did not have a profit from which dividends could have been paid during this period. Shares of stock were issued to the claimants herein on and after February 2, 1953, and none can be said to have been issued in a regular manner, that is, upon receipt of consideration passing directly to the Debtor. Moreover, the consideration for which the stock in Nazareth was issued was not the same in all cases: some investors gave Malakoff cash or checks; others received their interest in Nazareth by releasing funds which Malakoff held for them as proceeds from other ventures; others accepted Nazareth stock from Malakoff in exchange for stock in other Malakoff ventures that had proved worthless; and some of the claim-[fol. 10642] ants received interests in Nazareth in satisfaction of Malakoff's personal debts to them. In substantially all cases the certificates were not issued to the stock claimants at or about the time they allegedly gave consideration to Malakoff as an investment in Nazareth. Altogether 316 shares were issued, 116 more than were authorized, to the 41 claimants herein. On September 28, 1953, the Debtor filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act. To achieve a reorganization of the Debtor which, insofar as stock issuance and ownership are concerned, never had been properly organized, the trial court had to determine as a basic issue: who, if any, were entitled to participate in the stock of the reorganized Debtor. The Court referred the task of making this investigation to an Examiner (Bankruptcy Act of 1898, §§167, 168; 11 U. S. C. A. 567, 568). Testimony (some 10,000 pages) was taken concerning the circumstances under which the stock claimants had purportedly invested in the Nazareth Market or claimed to be entitled to participate as stockholders of the Debtor. In a detailed and painstaking report (236 pages), the Examiner carefully sifted the issues fundamental to the resolution of stock participation.

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[1] See *Cunningham* v. *Brown*, 265 U. S. 1 (1924).

In summary, he found that every claimant had acquired his or her stock by means of transactions with Malakoff or his agents; that none of the consideration therefor passed directly to the Debtor; that Malakoff and the claimants "ascribed little or no importance to the legal form which the venture took, or to the observance of the legal and other formalities and requisites of its corporate form"; that not one of the claimants "has a clear legal right to any of the shares which he or she claims"; and that he (the Examiner) should "apply equitable principles in the determination of who are the stockholders of the debtor and what proportions of its stock they hold."

[fol. 10643] Since the problem for the reorganization court is to decide upon the capitalization necessary to do equity in the light of the various claims before it, this court need pass only upon the immediate question of who should be stockholders of the reorganized debtor and in what proportions. With these basic principles determined, the solution becomes more clearly defined. One group of investors paid Malakoff by check, credit or cash various sums to purchase an interest in the Nazareth Market. The money was solicited for this purpose by Malakoff as the promoter of the enterprise and was not intended to be loans to Malakoff personally or to be used generally by him in his many business operations. The funds should have reached the Debtor's treasury and have been the consideration required by Pennsylvania law to support the valid issuance of the Debtor's shares. The other group consists of persons to whom Malakoff issued shares for antecedent personal debts, in exchange or substitution for shares of other ventures or for other obligations personal to Malakoff. From these persons the Debtor did not receive and was not intended to receive anything of value, either from them or from Malakoff. These shares as a matter of Pennsylvania law could have had no validity as an original issue. In

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[2] "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void." Pa. Const. art. XVI, §7, implemented in 15 Purdon's Pa. Stat. §2852-603(A) (1958).

many instances, however, Malakoff gave by assignment to persons in this group shares purportedly issued to him. Had these shares been validly issued to Malakoff then, but only then, would the principles of the Uniform Stock Transfer Act in force in Pennsylvania at the time of the [fol. 10644] transactions here involved as to consideration and "value" apply. But no such shares were ever validly issued to Malakoff. The 20 shares originally issued to Zoloth and Soble, although subsequently assigned to Malakoff and still later by him to the Debtor, did not come into the hands of any claimant. After the shares had been issued to the claimants from and after February 2, 1953, corporate minutes in May or June, 1953, were fraudulently prepared and pre-dated as of July 2, 1952 (or post-dated as of July 2, 1953) purporting to evidence the issuance of the remaining 180 shares to Malakoff for $75 a share. There is no proof that Malakoff ever paid for these shares or that they were legally issued. Thus no claimant can derive any rights by assignment from Malakoff on the theory that he was the owner of the Debtor's stock. The purported issuance was both fraudulent and invalid.

Despite the cloud of illegality obscuring any stock issuance, the Debtor came into corporate being and did acquire a valuable property which it still holds. The Market property is sufficient to support a valid stock issue to those entitled thereto. The sellers (Philadelphia group) have been paid for that property by Malakoff. Malakoff in turn obtained the money for this purpose from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a trustee, fiduciary, agent, promoter or syndicator (the terminology is unimportant—the facts create the rights) for those who gave him their funds for investment in the

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[3] "'Value' is any consideration sufficient to support a simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a certificate is taken either in satisfaction thereof or as security thereof." Uniform Stock Transfer Act §22(1), 15 Purdon's Pa. Stat. §322, now covered by Uniform Commercial Code §8-303, 12 A Purdon's Pa. Stat. §8-303 (1958).

project. They should in equity receive that for which they paid.

Although the findings of fact of the Examiner may be accepted almost in their entirety, his conclusions are at [fol. 10645] variance with the equitable principles applicable here. The Examiner treated Malakoff as the owner and operator of the Debtor and each claimant as having purchased his interest from Malakoff. This erroneous assumption made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory that stock transfers from Malakoff rested upon adequate consideration if the Stock Transfer Act's definition of "value" were satisfied. This, however, is not the problem. The Debtor's stock for all practical purposes has never been legally issued. Such stock as is to be issued in the reorganization should be based upon the requirements of Pennsylvania law with respect to the issuance of stock.[4]

Malakoff received the moneys put into his hands by the investors for the specific purpose of the allotment of shares in the Nazareth Market property. He used some of this money to acquire that property. Title thereto now is in the Debtor. The court upon reorganization is in a position to give to the investors that which they were originally entitled to receive.

At the time Malakoff obtained the investors' funds, he spoke in terms of the issuance of shares. To some he promised shares at $600; to others at $1,000. Although shares were purportedly issued, the "dividends" of 20% were paid and accepted on the basis of the amount invested. Greater equity will be achieved by calculating the allowed claims in terms of dollars rather than in invalidly issued shares. The "investors" had a right to expect that the sums delivered to Malakoff would represent their shares in the enterprise and would be delivered to the corporation. Therefore, in determining their interests the entire amount paid, undiminished by any so-called "dividends," must control their participation.

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[4] See footnote "2," *supra*.

[fol. 10646] As to the stock claimants, with few exceptions they fall into two distinct categories: (1) those investors who paid for a participation in the Nazareth Market by cash, check or credit, and (2) those who did not make any payment but who rely upon antecedent indebtedness of Malakoff and other transactions with him unrelated to the Nazareth venture as consideration.

In the first category are the claimants listed below whose claims should be allowed in the amounts indicated. As to these claimants, the findings of the Examiner and the trial court relating to the amounts paid to Malakoff and the circumstances under which they were paid are affirmed.

Name	*Amount*
Charles Kanter	$ 4,000.00
Morton Samet	2,000.00
Gertrude Klein	14,000.00
Dorothy Holober Clark	3,000.00
Barry Clark	4,000.00
Harold Q. Masur	4,000.00
Louis Como	6,000.00
Frank Como	6,000.00
Patsy Como	8,000.00
Anne Bikales	5,000.00
Lawrence Treat	2,000.00
Dorothy Kane	3,000.00
Miriam Klein	3,350.00
Ruth Spielholz	3,000.00
Mae Bluestone	2,000.00
Gussie Schwartz	2,000.00
Harold B. Schwartz	4,000.00
Lazar Karapantso	2,000.00
Ernest Pollak	9,000.00
H. Lawrence Laupheimer	7,750.00
Arnold A. Weinstein	7,000.00
[fol. 10647]	
Aaron Fried	3,000.00
George Bond	1,000.00
Tess J. Schwartz	3,000.00
Cydney Grosman	2,000.00

Name	*Amount*
Rose Kaplan	$ 1,000.00
Robert A. Noire	5,000.00
Richard S. Hull	3,600.00
Leslie Saul	3,000.00
Jerome Fried	2,000.00
Ann Rosen	6,000.00

Charles Kanter

As to the claimant, Kanter, there must be some modification of the Examiner's and trial court's conclusions. The Examiner found that after Malakoff in early 1951 had agreed to take a one-quarter interest in the Nazareth Market for $16,000, Kanter took one-quarter of this amount for $4,000 and gave Malakoff a check for $2,667 and cash or customers' checks for $1,333.33. Although Malakoff's promissory note for $4,000, dated April 11, 1951, signed as "Agent," is somewhat in conflict with the investment theory, nevertheless it is endorsed "For 1/16th of interest in Nazareth Market." Therefore, $4,000 may properly be placed in the investment category. The balance of Kanter's claim falls into the second category and must be disallowed.

In the second category are the claims which must be disallowed.

Herbert and Melvin Danciger

The Dancigers' claim is based upon a certificate for 11 shares given to them by Malakoff to secure a personal obligation arising out of a real estate operation unrelated to the Nazareth Market. The entire claim must be disallowed.

[fol. 10648] *Seymour Forman*

This claim to 15 shares is based upon a certificate for 15 shares issued in Malakoff's name and endorsed by him to Forman. Even this claimant does not contend that he intended to invest in Nazareth. At most, the shares (invalidly issued) were to secure loans. If Forman has a

claim based upon a loan for $5,000, or any other amount, to the Debtor, it must be considered independently of any claim to a stock interest. The stock claim must be disallowed.

Eskandar Manoochehrian

This claim is based upon two certificates totalling 20 shares. The claimant himself states the consideration to have been a loan of $20,000 to a corporation other than the Debtor. The claim clearly comes within the second category and must be disallowed in its entirety.

H. Forman

The claim for 10 shares involves two certificates for 5 shares each dated March 13, 1953, and April 23, 1953, respectively. The Examiner found that "At that time there were no open transactions between Forman and Malakoff and neither one owed the other any money"; that Forman delivered a check for $5,000 dated April 23, 1953, payable to Malakoff to cover Forman's agreement to buy 5 shares in the Nazareth project; that "It is perfectly plain that the transaction Forman had with Malakoff on or about the 17th day of March, 1953, was a security transaction so far as the Nazareth stock was concerned"; and that the second certificate "likewise seems to have been a security transaction despite Forman's testimony to the contrary." The April, 1953, payment of $5,000 for 5 shares is claimed to have been for an investment in Nazareth. However, the Examiner has found to the contrary on conflicting evi- [fol. 10649] dence and no showing has been made that such a finding is clearly erroneous. As a result, these facts place this claim in the second category and it must be disallowed.

Frederick Katzenell

Katzenell bases his claim upon an alleged Malakoff antecedent indebtedness of $28,000 and a $2,000 check given to Malakoff in September, 1951. The check, however, bears Katzenell's own notation of "loan." Neither the antecedent debt nor the loan support an investment in Nazareth and, hence, his claim must be disallowed.

Another group (the Margolis group) involved in a separate appeal (No. 26962) must be considered as potential participants. The Referee in Bankruptcy found no equity in favor of any claimant in this group, i.e., Benjamin Margolis (17 shares), William McK. Shongut (10 shares), Bernard Ungar (2 shares), Ida Margolis (15 shares) and Sarah Kason (10 shares).

Despite the fact that the Margolis appeal relates directly only to the district court's order permitting a reopening of the proceedings as to this group, there is sufficient proof before this court to enable us to indicate our views as to the rights of these claimants.

The claims of three of the five claimants in appeal No. 26962, Benjamin Margolis, Bernard Ungar and Sarah Kason, should be completely disallowed. These claims are based on certificates which were issued in satisfaction of Malakoff's personal debts or to replace worthless stock in other Malakoff ventures. The claims of William McK. Shongut and Ida Margolis should be allowed in part.

Benjamin Margolis

Benjamin Margolis claimed 17 shares, purchased in units of 10 and 9 (2 of the latter group were sold to claimant Ungar). For the former group, the consideration was debts [fol. 10650] owed personally by Malakoff to Mr. and Mrs. Margolis. For the latter, Margolis turned over shares in Wales Properties, Inc. (another Malakoff venture), specifically found by the Referee to be worthless. All of Margolis's claims should, therefore, be denied.

Bernard Ungar

Ungar gave Margolis $2,000 for two shares of Margolis's stock. Since this stock was never validly issued to Margolis, Ungar could obtain no better rights thereto. His only remedy is against Margolis.

Sarah Kason

Sarah Kason, Ida Margolis's mother, held 10 shares. The Referee found that these shares were issued as security

for money previously loaned to Malakoff personally by Ida Margolis, despite the fact that Mrs. Margolis claims the loans to have been to Nazareth. This finding appears reasonable and, therefore, the Kason claim should be denied.

William McK. Shongut

Shongut's 10 shares were acquired pursuant to an alleged agreement with Margolis whereby he delivered to Margolis, as attorney, his check for $10,000. Margolis deposited this check in his bank account and Margolis guaranteed Shongut an income on the stock of 20% a year for 6 years. Shongut actually had given this $10,000 to Margolis for investment in Nazareth. However, Margolis only gave by checks and cash $6,287.34 to Malakoff. Shongut, therefore, should be allowed $6,287.34; for the rest he must look to Margolis.

Ida Margolis

In 1951 Ida Margolis paid to Malakoff $9,000 for 15 shares. This amount should be treated in the same manner [fol. 10651] as the allowed claims in appeal No. 27,000. The remainder of her claim, however, is based on stock issued to her in payment of a personal debt of Malakoff and, therefore, must be disallowed.

All Margolis group claims should be disallowed except those of Ida Margolis for $9,000 and Shongut for $6,287.34, which should be allowed.

There remains for consideration the proper treatment which should be accorded the "dividend" payments. Moneys paid by investors, which should have been turned over to Debtor but were diverted to persons whose stock claims are disallowed, belonged in equity to the Debtor. However, the rights of the Debtor with respect to such recoupment, if any, as may be just and proper, are not within the issues on this appeal. Insofar as "dividend" payments were made to and received by claimants whose claims are allowed, the sums were obviously not dividends because there were no earnings to support such payments. They could therefore

only be regarded as distributions out of the Debtor's capital. The amounts received as found by the trial court should be a charge against any distributions to be made to these stockholders and any shares issued upon reorganization so endorsed or stamped as to indicate this liability to subsequent purchasers or transferees.

This opinion deals with the rights of the original recipients of Nazareth stock. There have been some transfers, including those noted in Docket No. 26,362 decided simultaneously herewith, dealing with certain purchases and sales by claimants, Weinstein and J. Fried. The conclusions in this opinion are without prejudice to such action as equitable principles may require with respect to these two claimants or others who have bought or sold stock.

Appellants' contention in No. 26,962 that the district court could not open the petition for review and receive [fol. 10652] new evidence, including the minutes of the hearings on the stock claims involved in appeal No. 27,000, is without merit. General Order No. 47 gives the district court the right to receive further evidence after receipt of a referee's report. The necessity for such a rule is demonstrated by the facts presented in this case. The Referee's decision, that none of the claimants could recover because none of them gave consideration which passed directly to the corporation, was wrong. In order to make an equitable determination of the claims presented by these five claimants, the district court deemed it necessary (probably for comparative purposes) to consider the factual basis for the allowance of the claims of the other claimants. In view of our disposition of the claims in Docket No. 27,000 and our views as to the claim in Docket No. 26,962 further evidence beyond that already available to the court would seem to be unnecessary.

This reorganization has been pending for over eight years. The Farmers Market appears to be a currently profitable operation. A rapid termination of the proceed-

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In the Matter of Kruthold, 3rd Cir., 1958, 256 F. 2d 181; *Powell v. Wilkes*, 3rd Cir., 1942, 142 F. 2d 4.

ing would be in the interest of the claimants and the courts, thus giving to those who some ten years ago thought that they were investing in the Market that which they should have received at the time.

The order in #27,000 is reversed except as specified in this opinion. The order in #26,962 is affirmed as to reception of so much of the minutes as does not concern evidence peculiar to the claimants in #27,000; otherwise, reversed. On the petitions to review the order of the Referee in Bankruptcy, the district court is directed to modify the order of October 5, 1957, in accordance with this opinion. No costs in Dockets #27,000 and #26,962.

[fol. 10653]

IN UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Present: Hon. Leonard P. Moore, Hon. Henry J. Friendly, Hon. J. Joseph Smith, Circuit Judges.

In the Matter of NAZARETH FAIRGROUNDS & FARMERS MARKET, INC., Debtor.

IRVING J. WOLF, ROBERT H. DAVIDSON, FREDERICK KATZENELL, RICHARD S. HULL, ARNOLD A. WEINSTEIN, JEROME FRIED, Appellants.

JUDGMENT—November 9, 1961

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court

be and it hereby is reversed except as specified in the opinion of this court.

A. Daniel Fusaro, Clerk.

[fol. 10654] [File endorsement omitted]

[fol. 10655] Petition for Rehearing Covering 18 Pages Filed November 21, 1961 Omitted From This Print. It Was Denied, and Nothing More by Order—November 29, 1961

[fol. 10656]

In United States Court of Appeals

Second Circuit

Present: Hon. Leonard P. Moore, Hon. Henry J. Friendly, Hon. J. Joseph Smith, Circuit Judges.

In the Matter of Nazareth Fair Grounds & Farmers' Market, Inc., Debtor,

Arnold A. Weinstein, Jerome Fried, and Irving J. Wolf, et al., Appellants,

v.

Nazareth Fair Grounds & Farmers' Market, Inc., et al., Appellees.

Order Denying Petition for Rehearing —November 29, 1961

A petition for a rehearing having been filed herein by counsel Irving J. Wolf, Robert H. Davidson, Richard S. Hull and Frederick Katzenell,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. Daniel Fusaro, Clerk.

[fol. 10657] [File endorsement omitted]

[fol. 10658] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 10659]

SUPREME COURT OF THE UNITED STATES

No. 739, October Term, 1961

IRVING J. WOLF, et al., Petitioners,

vs.

ARNOLD A. WEINSTEIN, et al.

ORDER ALLOWING CERTIORARI—April 2, 1962

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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Supreme Court of the United States

October Term, 1961

No. [redacted]

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

In the Matter
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

PETITION FOR WRITS OF CERTIORARI to the United States Court of Appeals for the Second Circuit

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

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Supreme Court of the United States

October Term, 1961

No.

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

In the Matter
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

PETITION FOR WRITS OF CERTIORARI to the United States Court of Appeals for the Second Circuit

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

Petitioners Irving J. Wolf, Robert H. Davidson, Richard S. Hull, and Frederick Katzenell pray that Writs of Certiorari issue to review the judgments of the United States

Court of Appeals for the Second Circuit, entered in the above companion cases, Docket No. 26362 and Docket No. 27000, on November 9, 1961.[1]

Opinions Below

In No. 26362, the District Court for the Southern District of New York (*per* SUGARMAN, *D. J.*) rendered a memorandum opinion on January 4, 1960 (R vol. III, 7a) and an opinion from the bench on June 14, 1960 (R vol. III, 1a-20a), and made findings of fact and conclusions of law, dated November 7, 1960, and filed November 23, 1960 (R vol. III, 21a-30a); they are not reported. In No. 27000, said District Court made findings of fact and conclusions of law, dated and filed October 19, 1960 (R 3a-18a); they are not reported, and there is no opinion. The opinions of the Court of Appeals for the Second Circuit (*before* MOORE, FRIENDLY, and SMITH, *Cir. JJ.*) in No. 26362 (*per* FRIENDLY, *Cir. J.*) (R vol. IV, 18a-31a) and in No. 27000 (*per* MOORE, *Cir. J.*) (R24a-39a) are reported at 296 F. 2d 678 and 296 F. 2d 670 (respectively).

Jurisdiction

The judgments of the Court of Appeals for the Second Circuit were made and entered on November 9, 1961 (No. 26362: R vol. IV, 32a; No. 27000: R 40a). Petitions for rehearing of both cases were filed by Petitioners on November 21, 1961 (No. 26362: R vol. IV, 34a; No. 27000: R 42a), and were denied without further opinion on November 29, 1961 (No. 26362: R vol. IV, 40a; No. 27000: R 59a). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

---

[1] Arnold A. Weinstein, Jerome Fried, and Nazareth Fair Grounds & Farmers' Market, Inc. (the Debtor in posession, a nominal party) are Respondents in both No. 26362 and No. 27000. An additional Respondent in No. 26362 is Nazareth Enterprises, Inc. Additional Respondents in No. 27000 are all the beneficial owners of stock-claims besides the named Petitioners and Respondents. Petitioners do *not* seek review of a third companion case, No. 26962 (*see App. A*).

Questions Presented

No. 26362

1. A Chapter X court has been petitioned to *remove* fiduciaries from office on the grounds of their personal trading in the debtor's stock *during* the reorganization proceedings and their diversions of the debtor's rents to themselves *during* the proceedings, and (on the same grounds) to deny them *compensation* out of the estate for services rendered by them *during* the proceedings. By statute, and as an equity receivership court, the Chapter X court has exclusive jurisdiction over the continued service of *all* fiduciaries and over the "reasonableness" of *all* compensation paid to *all* fiduciaries. In exercising that jurisdiction, is there a *double standard* which (a) requires the court to apply a strict *federal* standard of fiduciary conduct to those fiduciaries *alone* who were "disinterested" at the *commencement* of the proceedings, (b) yet permits the court to apply a different, looser *state* standard of fiduciary conduct to those fiduciaries who serve *during* the proceedings, but who were *not* "disinterested" at the *commencement* of the proceedings?

2. Does the payment of compensation to the officers of a Chapter X debtor in possession *week-by-week during* the proceedings, *exempt* such officers from the mandate and bar of § 249—that "No compensation or reimbursement shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold * * * stock [of the debtor] * * *."—although payment of compensation to such officers *in gross at the winding-up* of the proceedings, would be absolutely barred by § 249?

No. 27000

3. In a Chapter X reorganization proceeding, in adjudicating *claims* to stock interests in the debtor, which interests vested under state law prior to commencement of the

reorganization proceedings, and where no supervening federal statute or policy exists: Is the federal court (having *non-diversity* jurisdiction) required to apply *state rules of decision in equity?* If so, does the application of such state rules of decision extend to *remedies* as well as rights?

Statement of the Case

The Debtor was incorporated in Pennsylvania on August 7, 1951, to operate a "farmers' market". Its sole assets are land and buildings at a highway junction in Nazareth, Pennsylvania. It rents space inside the buildings to merchants, and an outside race-track for stock-car racing. Its sole earnings are those rents.

The Debtor was organized by the "Philadelphia Group", a joint venture which had acquired the realty on April 17, 1951, and conveyed it to the Debtor on September 26, 1951, at their cost. The Debtor paid the Philadelphia Group part of the price by an original issue of 20 shares (of nominal book value, and the only outstanding stock until February of 1953). On October 17, 1951, the Philadelphia Group sold their entire interest (including the 20 shares) to John Malakoff, at a profit. From April of 1951, when he had bought a ¼ interest in the venture, to 1952, Malakoff personally paid the Philadelphia Group, in irregular installments, most of the purchase price of the realty and the stock; eventually, they forgave him the balance due.

Malakoff undertook a clumsy real estate "syndication" or promotion. Between April of 1951 and April of 1953, he sold "shares" in the Market to at least 41 persons. Every purchaser paid Malakoff personally (some by cash; some by check, some by credit against Malakoff's debts); he received substantially more from those purchasers than he paid the Philadelphia Group. In turn, Malakoff paid "dividends" to the purchasers, in regular monthly installments out of his own bank accounts, mostly computed at 20% per year on their original advances to him. Virtually all the transac-

tions occurred in New York, where Malakoff and most of the purchasers resided. The prices and other terms varied radically over the two-year period. Generally, the "shares" were described as $n/200$ of the Market; most were sold for $1,000 per "share". Until the delivery of the stock certificates early in 1953, most of the purchasers held only letter-receipts from Malakoff as evidence of their payments and other terms of their transactions with him. Of the several forms used, the most common—drafted by respondent Weinstein, as Malakoff's lawyer—was the following:

> "You understand, of course, that *all of the authorized stock* of The Nazareth Farmers and Auction Market Inc. [*sic*] which owns the Market *has been issued to me.* * * *
>
> "In the course of my management of the Market, I may cause to be issued to you shares *of my present stockholdings.* In the other hand, I may cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your shares will be applied as your contribution with a corresponding proportionate interest. * * *
>
> "It is contemplated that the construction, performance, and execution of our understanding shall be governed by the Laws of the State of New York." (R13442; emphasis supplied.)

Not later than June of 1952, Malakoff took control of the Debtor. He became its president and a director; his employee, respondent Fried, became secretary-treasurer, a director, and general manager. In August of 1952, Fried (acting for the Debtor as landlord) leased the race-track to Fried's then-partner for ten years; in April of 1953, Fried's corporation (Nazareth Enterprises, Inc.) took over the lease as tenant.

By early 1953, Malakoff was in financial trouble. Between February and April, he caused the Debtor to issue

and deliver stock certificates (co-signed by Malakoff and Fried) to evidence the "shares" Malakoff had sold. The Debtor's charter authorized the issuance of 200 shares, and Malakoff had represented the "share" total as 200; in fact, he oversold, and he caused the issuance of at least 316 shares.

By May of 1953, Malakoff's "dividend" checks had stopped. The stockholders, previously dormant, then interceded. In June, Malakoff surrendered his own stock (the original 20 shares) to the Debtor, and Malakoff and Fried resigned as officers and directors. At a stockholders' meeting on June 29, 1953, Weinstein was elected president and a director. He continued Fried's service as general manager.

The Debtor was and is solvent in the bankruptcy sense. The major problem was to determine the ownership of the Debtor's stock. In effect, in order to resolve that problem, the Debtor selected the Chapter X court as a convenient forum with sweeping jurisdiction over all 41 parties and the subject matter.

On September 28, 1953, on a voluntary petition verified by Weinstein as president, the Debtor entered Chapter X reorganization proceedings in the Southern District of New York. The *ex parte* orders signed that day continued the Debtor in possession, provided that the Debtor "by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of" the Debtor, and authorized payment of a weekly salary to Fried as general manager (R10660, 10663, 10807-11). Later orders increased Fried's salary, and authorized a weekly salary to Weinstein, too.

No. 27000

In 1955 and 1956, the District Court issued "bar orders" [2] which compelled all the stockholders to file proofs of claim to stock interests in the Debtor (R13492). The Debtor's

[2] *See* Bankruptcy Act, § 196; 11 U. S. C. § 596; 52 Stat. 893 (1938); *see also*, 6 Collier on Bankruptcy (14th ed.) ¶¶ 9.03, 9.04.

answers (verified by Weinstein as president) objected to the allowance of every single stock-claim and asked cancellation of all the stock; alternatively, the Debtor counterclaimed for the subscription price of any stock which might be validated. (Malakoff had died, insolvent, in 1955; he was never a party to the proceedings.) After 86 trial days in 1958 and 1959, and a 10,000-page record on the 36 stock-claims involved in No. 27000, the District Court, by order dated December 8, 1960, allowed *all* the stock-claimants to participate in the estate, according to the "net fair value" of their respective "investments" (*i.e.*, their advances to Malakoff, less "dividends" received). The Debtor's counterclaims for the stock subscription price were denied (R3a-23a).

Three appeals were taken, by Petitioners and by Weinstein and Fried (each acting individually). The Debtor did not appeal; however, on Weinstein's authorization, the Debtor, as appellee, attacked the District Court's allowance of 10 of the 36 claims involved in No. 27000, including the four claims involved in the Weinstein-Fried appeals. Neither the Debtor nor any other party appealed from the denial of the Debtor's counterclaims for the stock subscription prices (by contrast to the allowances and awards to the stock-claimants).

On November 9, 1961, the Court of Appeals reversed, and effectually adopted the rationale of Weinstein and Fried. The Court of Appeals set up two classes of stock-claimants. Five stock-claims, and most of a sixth, were disallowed; that stock was cancelled. The other 30 stock-claims were allowed according to the respective sums advanced to Malakoff, but without deduction of "dividends".

In sum, both the District Court and the Court of Appeals, purporting to apply Pennsylvania corporation law, held *all* the Debtor's outstanding stock absolutely void for lack of consideration to the Debtor. Then, on general principles of "equity", without further reference to state law, and as though there were no corporation, both courts undertook to distribute the assets of the Debtor anew. Shares of stock

were to be issued proportionate to the prevailing stock-claimants' equitable "interests" in the Debtor's assets. Free of any applicable *law*, the courts below differed substantially in their respective views of the facts and the "equities".

No. 26362

During the reorganization proceedings, Weinstein and Fried engaged in two courses of conduct which became the subject of the petitions in No. 26362. Here, unlike No. 27000, the material facts are undisputed.

1. Weinstein and Fried, for their own accounts and for others, bought and sold the Debtor's stock. *E.g.*: (a) In May of 1957, Weinstein, acting for his sister, bought six shares, originally purchased from Malakoff as 3.0% of the total (200) shares, and equal to 4.11% under the decision below. (*See* R vol. III, 31a-32a.) (b) In January of 1958, Weinstein bought ⅔ of one share for himself, originally purchased from Malakoff as 0.33%, and equal to 0.46% under the decision below. (c) In March of 1959, Weinstein, acting for Fried, bought 8 shares, originally purchased from Malakoff as 4.0%, and equal to 5.48% under the decision below.

2. Not later than 1955, Weinstein and Fried agreed: (a) that the percentage rent payable by Fried's race-track corporation to the Debtor on the race-track gross receipts (under the lease made by Fried in 1952), be reduced from 12% or 15% to 10% and 7%; and (b) that the rents theretofore paid by a food concessionaire to the Debtor, thereafter be retained by Fried's corporation. No disclosure was made to the court until 1959. (R vol. III, 32a-48a.)

Having been stockholders, directors, and officers of the Debtor, Weinstein and Fried were not "disinterested" at the commencement of the proceedings.[3]

On June 14, 1960, the District Court terminated the compensation of Weinstein and Fried for trading in the Debtor's stock (under § 249 alone), and effectually removed them from

[3] Bankruptcy Act, § 168; 11 U. S. C. § 568; 52 Stat. 888 (1938).

office as president and general manager (respectively). No decision was then made as to the race-track rent diversions. On June 28, 1961, the District Court finally decided a related but severed petition involving the race-track rents, and held that Fried owed the Debtor back-rents exceeding $22,000 (R vol. IV, 1a); cross-appeals from that decison are now pending. On July 12, 1960, the Court of Appeals had stayed the removal of Weinstein and Fried from office pending appeal. On November 9, 1961, the Court of Appeals reversed the District Court both as to the removal of Weinstein and Fried from office and as to the termination of their compensation. The Court of Appeals held § 249 inapplicable, as a matter of law, and found no breach of trust by Weinstein or Fried in their trading in the Debtor's stock during the proceedings, as a matter of law. Though omitting even to mention the race-track rent diversions (the alternative grounds of the petitions for removal from office and denial of compensation), and refusing to remand, the Court of Appeals likewise found no breach of trust by Weinstein or Fried in their rent diversions. (*See* R vol. IV, 34a).

Reasons for Granting the Writ

No. 26362

In No. 26362, for the first time, a Court of Appeals—the bellwether Second Circuit—has broken with the consistent line of decisions in every Circuit where § 249 of Chapter X has been presented since its enactment in 1938. The questions involving § 249 have never been ruled on by this Court.

In addition, the Second Circuit Court of Appeals has decided questions involving § 221(4) of Chapter X in a way in conflict with applicable decisions of this Court.[4]

The questions of federal reorganization legislation and equity practice presented in No. 26362 are important and

[4] Woods v. City National Bank & Trust Co., 312 U. S. 262 (1941, per Douglas, J.); *see also*, American Mutual Life Insurance Co. v. City of Avon Park, 311 U. S. 138 (1940, per Douglas, J.)

should be settled by this Court. The decision below is in error and should be reversed.

No. 26362 relates to the administration of estates in the custody of the federal courts during Chapter X bankruptcy reorganization proceedings. The paramount principles are: (a) the prohibition of insider trading in the debtor's securities during the proceedings, as a Congressional and judicial *end* and policy, *per se;* and (b) the denial of compensation from the estate to insiders who trade despite the prohibition, as the *means* of effectuating that policy and attaining that end. The decison below confounds that policy, and clouds a hitherto clear *caveat* to insiders.

The crucial statutes are § 249 [5] and § 221(4),[6] enacted in 1938:

> "§ 249. * * * No compensation * * * shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, * * *."

> "§ 221. The judge shall confirm a plan if satisfied that— * * *
>
> "(4) all payments made or promised by the debtor * * *, for services * * * in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable * * *; * * *."

Chapter X's predecessor, § 77B, enacted in 1934, contained no explicit provision comparable to § 249.[7] Section 77B(f)(5) was expanded and became § 221(4) of Chapter X.[8]

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[5] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).

[6] Bankruptcy Act, § 221(4); 11 U. S. C. § 621(4); 52 Stat. 897 (1938).

[7] *See* 6 Collier on Bankruptcy (14th ed.) ¶¶ 13.01, 13.18.

[8] *See ibid.*, ¶¶ 11.01, 11.09; Bankruptcy Act, § 77B(f)(5); 11 U. S. C. § 207(f)(5); 48 Stat. 919 (1934) [*Repealed*].

Before 1934, reorganizations had been effected in equity receiverships, and were infamous for insiders' abuse of the judicial process to reap windfalls for themselves by using confidential information in buying and selling the debtor's securities for their own accounts during the proceedings. Virtually all control over compensation and expenses had been left by the courts in the hands of private parties, especially old management and the "protective committees."[9] One of the major innovations of § 77B in 1934 was judicial control over compensation and expenses,[10] under § 77B(c).[11]

Under § 77B, two reorganizations in the Southern District of New York presented situations where committee members, applying to the reorganization courts for allowances of compensation, were found to have traded in securities of the debtor during the proceedings—and therefore were denied all compensation: *Paramount-Publix*[12] and *Republic Gas*.[13] In *Paramount-Publix*, in 1935, Judge Coxe invoked the phrase "reasonable compensation" in § 77B(c) and § 77B(f)(5) as statutory authority for applying principles of equity:

> "The statute [§ 77B(c)(9)] permits the payment of *reasonable compensation* to committee members 'for services rendered.' *This necessarily implies loyal and disinterested service* in the interest of the persons for whom the committee assumes to act, and a committee member who, during his period of service, purchases and sells, or purchases, for personal gain, securities of the company which he is engaged in trying to reorganize, is not entitled to an allowance for his

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[9] *See* 6 Collier on Bankruptcy (14th ed.) ¶ 0.04.

[10] *See ibid.*, ¶¶ 0.04, 0.05.

[11] Bankruptcy Act, § 77B(c); 11 U. S. C. § 207(c); 48 Stat. 915 (1934). [*Repealed.*]

[12] *In re* Paramount-Publix Corp., 12 F. Supp. 823 (S. D. N. Y., 1935, per Coxe, J.).

[13] *In re* Republic Gas Corp., 35 F. Supp. 300 (S. D. N. Y., 1936, per Caffey, J.).

> services as a committee member." 12 F. S. at 828 (emphasis supplied).

A year later, in *Republic Gas*, Judge Caffey quoted Judge Coxe's opinion in *Paramount-Publix*, and followed Judge Coxe's reasoning and decision.

In 1938, the Chandler Act replaced § 77B with Chapter X. Many provisions of § 77B were carried over into Chapter X, and clarified. *Expansion* of § 77B was intended. The new format of Chapter X was stated explicitly, by statute, *not* to restrict the substantive application of any sections of Chapter X;

> "b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate." [14]

Thus, notwithstanding the decision below, it is quite arbitrary to define the "context" of § 249 as less than all of Chapter X. (*Cf. App.* 54a.)

A major purpose of the new reorganization legislation in 1938 was to prevent *all* fiduciaries from *any* traffic in the securities of the debtor they were engaged in operating and reorganizing during the proceedings. Provision for recouping insider profits was carried over from § 77B(b) to § 212 of Chapter X;[15] for both reorganization legislation and securities regulation enacted by Congress in the 1930s were in the same context, subject to the same influences, and largely directed to the same objectives.[16] But, *in addition* to § 212, the Chandler Act enacted § 249; that is, *in addition* to restitution of insider profits, Congress prohibited compensation to insiders who traded during the proceedings—

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[14] Additional Provisions of the Act of June 22, 1938 (The Chandler Act, ch. 575, 52 Stat. 840), § 5b; 11 U. S. C. § 1, notes. *See* Report No. 1916 of Senate Judiciary Committee on H. R. 8046 (1938); 6 Collier on Bankruptcy (14th ed.) ¶¶ 13.02, 13.16.

[15] Bankruptcy Act § 212; 11 U. S. C. § 612; 52 Stat. 895 (1938). *See* 6 Collier on Bankruptcy (14th ed.) ¶ 9.31.

[16] *See, e.g.*, Report of Percival E. Jackson, Counsel to Special Committee of U. S. Senate to Investigate Bankruptcy and Receivership Proceedings, etc. (April 15, 1936), at pp. 51-3, 87; 2 Loss, Securities Regulation (2d ed., 1961), at pp. 719-720, 1124-6.

irrespective of profits. The two sections—§ 212 and § 249—are cumulative, not exclusive.[17]

The legislative history and purpose of § 249 may be seen, for example, in a statement to the House Judiciary Committee in 1937, made by William O. Douglas, a principal draftsman of Chapter X, and then a commissioner of the S. E. C., in explanation and support of § 249:

> "The Chandler bill makes further significant changes in that respect. On page 65 there is a very important provision, that those who have purchased or sold securities in contemplation of or after commencement of the proceedings should not be allowed compensation or reimbursement from the estate. Now, this is a development of the idea that fiduciaries who trade in the securities should be penalized; that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law. * * *
>
> "Now, Judge Coxe up in New York in the *Paramount* case, and Judge Caffey in the *Republic Gas* case, the opinions which were handed down in 1935 and 1936, respectively, disallowed compensation to committee members who purchased or sold securities. Now, this provision on page 65, is a step toward the codification of that rule, an attempt to make it more uniform.
>
> "Mr. Celler: Due to their position they trade in the securities and gain a tremendous advantage?

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[17] *See* 6 Collier on Bankruptcy (14th ed.) ¶ 9.31. In the following Chapter X cases, *both* § 212 and § 249 were applied as remedies for insider trading: Young v. Potts, 161 F. 2d 597 (6th Cir., 1947, *per* Simons, J.), *on remand from* Young v. Higbee Co., 324 U. S. 204 (1945, per Black, J.); *In re* Philadelphia & Western Ry. Co., 64 F. S. 738 (E. D. Pa., 1946, per Kirkpatrick, J.); *In re* Los Angeles Lumber Products Co., Ltd., 37 F. S. 708; 46 F. S. 77 (S. D. Cal., 1941, per Jenney, J.).

> "Mr. Douglas: Yes; by using inside information. * * * so we decided that the best practical way of doing it was to broaden the base a little bit and establish a rule of thumb and follow the pattern of the *Paramount* case and the *Republic Gas* case." [18]

Since § 249 became law in 1938, this Court has never reviewed a § 249 case. However, this Court has stated:

> "* * * In all cases persons who seek compensation for services or reimbursement for expenses are held to fiduciary standards. § 249, * * *; Woods v. City Nat. Bank & T. Co. [citation]. * * *" [20]

In any event, no need for this Court to review a § 249 case had arisen—until now. For invariably, *all* fiduciaries who traded for their own accounts during Chapter X proceedings, were held subject to § 249. Motivation, ignorance, inadvertence, gain or loss: invariably, all were held irrelevant. The Courts of Appeals rigorously applied § 249 in accordance with its legislative history and purpose, from the first appellate decision in 1940—

> "* * * It is doubtless true that the statute, thus construed, may work a hardship in some cases—as in this; but such sporadic cases are inconsiderable compared to the large object sought to be achieved by the law, which is to fix a standard of conduct by persons acting in fiduciary capacities, in these cases, so high as to prevent any possible clash between selfish interest and faithful performance of duty." [21]

—to the last, in 1959—

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[18] Hearings before House Judiciary Committee on H. R. 6439, 75th Cong., 1st Sess. (1937), at pp. 183-4.

[20] Brown v. Gerdes, 321 U. S. 178, *at* 182 (1944, *per* Douglas, J.).

[21] Otis & Co. v. Insurance Bldg. Corp., 110 F. 2d 333, at 335 (1st Cir., 1940, per Peters, D. J.).

> "• • • But in § 249 of the Bankruptcy Act Congress clearly intended drastic results and thought them necessary to eliminate the serious abuses of insider information which had long been existent in equity reorganizations. [Citation.] In the past excuses of inadvertence or *de minimis* have not been permitted to undermine the section, and we do not feel we can narrowly constrict it here. [Cases cited.]" [22]

While this Court has not ruled on § 249, this Court has, since 1938, ruled on numerous reorganization cases involving compensation to fiduciaries. Repeatedly, this Court has held that the Chapter X courts must control the acquisition and distribution of *all* assets of the estate,[23] and that the Chapter X courts have and must exercise *exclusive* jurisdiction and control over *all* compensation which, directly or indirectly, is paid out of the estate and which thus affects the ultimate distribution of assets in judicial custody.[24]

> "Hence Congress instituted controls, controls which became more pervasive as § 77B was evolved into Chapter X. • • •. And § 221(4) is written in pervasive terms—it applies to 'all payments' for services 'in connection with' the proceeding or 'in connection with' the plan and 'incident to' the reorganization, whoever pays them. • • •" [25]

> "These practical considerations support the literal reading of § 221(4) that it is the bankruptcy court that has jurisdiction to pass on these fees. Its jurisdiction is therefore exclusive. • • •" [26]

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[22] Surface Transit, Inc. v. Saxe, Bacon & O'Shea, *266* F. 2d 862, *at* 868 (2d Cir., 1959, *per* Clark, C. J.), *cert. den.* 361 U. S. 862 (1959).

[23] *E.g.*, U. S. v. Knight, 336 U. S. 505 (1949, per Douglas, J.).

[24] Brown v. Gerdes, *supra*, note 20; Leiman v. Guttman, 336 U. S. 1 (1949, per Douglas, J.); *see* Austrian v. Williams, 216 F. 2d 278 (2d Cir., 1954, per Harlan, J.), *cert. den.* [*sub nom.* Fogarty v. Austrian] 348 U. S. 953 (1955).

[25] Leiman v. Guttman, *supra*, note 24, 336 U. S. at 7-8.

[26] *Id.*, 336 U. S. at 9.

By statute, the Chapter X courts have retained all the powers of an equity receivership court.[27] Moreover, even where § 249 does not apply—that is, in Chapter X proceedings, where conflicts of interest exist other than trading in the debtor's securities—this Court has likewise denied compensation to the faithless fiduciaries. Statutory authority is given by § 221(4), a "scrutiny clause" which was carried over into Chapter X from § 77B(f)(5). The same statutory language—"reasonable compensation"—is used in § 221(4) as was used in § 77B(c) and § 77B(f)(5), the sections which were the statutory authority for *Paramount-Publix* and *Republic Gas;* and *Paramount-Publix* has been quoted and followed by this Court in applying the "scrutiny clause" of § 221(4) to deny compensation to Chapter X fiduciaries who had conflicts of interest during the proceedings.

> "Under chap. X of the Chandler Act the bankruptcy court has plenary power to review all fees and expenses in connection with the reorganization from whatever source they may be payable. [Footnote, quoting § 221(4).] Reasonable compensation may be allowed. * * * Furthermore, 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act. * * * It is no answer to say that fraud or unfairness were not shown to have resulted. * * * Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation." [28]

* * *

Despite the foregoing history and law, the Court of Appeals held both § 249 and the strict federal standard of the *Woods* case inapplicable to Weinstein and Fried. Now a

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[27] Bankruptcy Act, § 115; 11 U. S. C. § 515; 52 Stat. 884 (1938).

[28] Woods v. City National Bank & Trust Co., *supra,* note 4, 312 U. S. at 267-8; *see* American Mutual Life Insurance Co. v. City of Avon Park, *supra,* note 4, 311 U. S. at 147.

double standard was posited. The fiduciary conduct of Weinstein and Fried was to be judged by a looser state standard, because they had been appointed and compensated "consensually". Under that looser standard, their trading in the Debtor's stock and their diverting its rents were not in breach of trust.

The following words are the crux of Judge Friendly's opinion in No. 26362:

> "* * * Not being required to seek compensation under § 247, they have not been subjected to § 249, and the order of removal cannot survive the fall of its underpinning. [Footnote 5]" (*App.* 55a.)

> "* * * For these strangers the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from *consensual arrangements*, subject only, in the case of officers, to judicial approval under § 191. * * *" (*App.* 55a; emphasis supplied.)

> "* * * Chapter X clearly distinguishes between *what is demanded* of a trustee and *what is expected* of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional trustee * * *) must be *'disinterested,'* * * *. No such requirement was or practically could be imposed on officers of the debtor; * * *." (*App.* 56a; emphasis supplied.)

> "* * * Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees complain; * * *." (*App.* 58a.)

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[29] Bankruptcy Act, § 156; 11 U. S. C. § 556; 52 Stat. 888 (1938).
[30] Bankruptcy Act, § 157; 11 U. S. C. § 557; 52 Stat. 888 (1938).
[31] Bankruptcy Act, § 168; 11 U. S. C. § 568; 52 Stat. 890 (1938).

1. Under Chapter X, *only* the trustee,[29] the trustee's attorney,[30] and the examiner[31] are required to be "disinterested."[32] It is not alone the officers and employees of a debtor in possession who need not be "disinterested." Likewise, virtually every other person serving in the proceedings, and looking to the estate for compensation, need not be "disinterested"; *e.g.*, the "additional trustee,"[33] attorneys employed on specific retainers,[34] indenture trustees, committee members. Except the trustee, the additional trustee, the trustee's attorney, and the examiner, all those persons are appointed by "consensual arrangements" with their clients —but all appointments remain subject to judicial approval.[35] As likely as not, those persons (*e.g.*, indenture trustees) will have served before as well as during the proceedings. Their compensation may have been fixed by contract with the clients or classes they represent; the contracts may have been executed either before or during reorganization; and they may be paid by their clients out of court, not by the trustee's disbursement.[36] Nevertheless, under § 221(4), the Chapter X court *must* review the "reasonableness" of their compensation.[37] But under the interpretation below, "reasonableness" no longer "necessarily implies loyal and disinterested service."

2. At once, there is a new order when a Chapter X petition is filed: federal law supervenes; the federal judge, above the stockholders, above the state legislature, is master; the debtor's officers are his servants. Some officers the judge newly appoints; some continue in service at executive level with his approval. The latter are compensated by regular salaries, instead of in gross at the winding-up.[38] Now, says

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[32] Bankruptcy Act, § 158; 11 U. S. C. § 558; 52 Stat. 888 (1938).
[33] Bankruptcy Act, § 156, *supra*, note 29.
[34] Bankruptcy Act, § 157, *supra*, note 30.
[35] Bankruptcy Act, § 212, *supra*, note 14; § 157, *supra*, note 30; § 191, 11 U. S. C. § 591, 52 Stat. 893 (1938).
[36] *See, e.g.*, Leiman v. Guttman, *supra*, note 24.
[37] Bankruptcy Act, § 221(4), *supra*, note 6; *see* cases cited in note 24, *supra*.
[38] Bankruptcy Act, § 191, *supra*, note 35.

the Court of Appeals, the correlate of that *privilege* of continued service and regular salary (without "disinterestedness") would be, not a responsibility, but a license to trade in the debtor's securities during the proceedings, as before. Their trading would still be no breach of trust, absent proof of actual over-reaching and actual profit; even then, the remedy would be limited to restitution of their profits. In short, fiduciaries not required to *be* "disinterested" at the *commencement* of the Chapter X proceedings, would *also not* be required to *act* in a disinterested manner *during* the Chapter X proceedings. For them, Chapter X would bring no change. The strict federal standard would apply only to the few "disinterested" at commencement, while the loose non-federal standard would apply to the many not "disinterested"— though *all* had "assumed *to act in the proceedings* in a fiduciary capacity."

3. The Court of Appeals would disregard the *functions* of key operating personnel, their access to confidential information, and their actual control of the debtor being reorganized. Not their powers and acts, but their titles, would define their responsibilities—despite the lucid functional definitions of the Bankruptcy Act [39] and the equity courts.[40] Form, not substance, would govern.

4. The decision below does not merely chip at § 249. It cleaves the statute and emasculates judicial control of compensation in Chapter X proceedings, thereby thwarting the Congressional and judicial purpose of preventing and penalizing insider trading. For the license to trade given by that decision would extend, not only to officers of a debtor in possession in a small case, but to all key operating personnel employed by a trustee or a debtor, in any case, big or small.

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[39] Bankruptcy Act, §§ 1(22), 1(23); 11 U. S. C. §§ 1(22), 1(23); 52 Stat. 840 (1938) ("officer" and "person", respectively). *See* Bankruptcy Act, § 188; 11 U. S. C. § 588; 52 Stat. 892 (1938).

[40] *See, e.g., In re* Frazin & Oppenheim, 181 Fed. 307, at 309 (2d Cir., 1910, per Noyes, J.).

Moreover, the refusal to apply § 249 or § 221(4) or non-statutory principles of equity in Chapter X proceedings, would be precedent for like refusal in railroad reorganizations under § 77,[41] in S.E.C. public utility reorganizations,[42] and in other reorganization proceedings under the Bankruptcy Act,[43] where the applicable statutes all contain language similar to the language of § 249 or § 221(4).

5. The double standard posited by the Court of Appeals is utterly inconsistent with the single and absolute standard which should be exacted of all fiduciaries in Chapter X proceedings, regardless of their mode of compensation and their mode of appointment. It is the *source of compensation* —the estate in judicial custody—which gives the Chapter X court exclusive jurisdiction over compensation *and* which should impose a single standard of conduct and compensation for all Chapter X fiduciaries.

By statute, the Chapter X judge must approve all appointments and must approve all compensation. The jurisdiction over compensation is exclusive. Unless that exclusive jurisdiction over compensation carries with it the substantive fiduciary standards set by § 249 and § 221(4), the jurisdiction is hollow.

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[41] *See* R. F. C. v. Bankers Trust Co., 318 U. S. 163 (1943, *per* Roberts, J.; Douglas, J., *concurring*); *see also*, 5 Collier on Bankruptcy (14th ed.) ¶ 77.28.

[42] *See* S. E. C. v. Dumaine, 218 F. 2d 308 (1st Cir., 1954, *per* Woodbury, J.) *cert. den.* 349 U. S. 929 (1955); *and see* 2 Loss, Securities Regulation (2d ed., 1961), at pp. 1127-9.

[43] *E.g.*, Ch. IX; *see* American Mutual Life Insurance Co. v. City of Avon Park, *supra*, note 4; *and see* 5 Collier on Bankruptcy (14th ed.) ¶ 81.23.

No. 27000

No. 27000 relates to the allowance and disallowance of claims to stock interests in the Debtor. The Court of Appeals has cancelled and reduced a large proportion of the shares of stock of record. Important questions involving corporations and trusts have been decided in a way in conflict with applicable Pennsylvania and New York law. In so deciding, the Court of Appeals has erroneously chosen to disregard state rules of decision, and instead to apply a species of "general law," especially as to remedies in equity. The applicability of state rules of decision in bankruptcy reorganization proceedings and other federal *nondiversity* cases, presents a question of federal law which is recurrent and important, and which has not been, but should be, settled by this Court.[44]

The Court of Appeals reached its decision in two major steps. First, purporting to apply Pennsylvania law as to the rights (but not the remedies), the Court treated *all* the Debtor's outstanding stock as void for lack of consideration to the Debtor. Secondly, the Court distributed the beneficial ownership of the Debtor's assets anew: The Court impressed a purchase-money resulting trust on the Debtor's assets, through Malakoff as trustee, and then issued new corporate stock in lieu of direct participating interests in the Debtor's realty. In effecting the distribution, the Court below did *not* purport to apply Pennsylvania or New York rules of decision; rather, the Court applied its independent conception of "federal equity."

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[44] *See* Russell v. Todd, 309 U. S. 280, *at* 294 (1940, *per* Stone, J.) (*nondiversity*); Guaranty Trust Co. v. York, 326 U. S. 99, *at* 99-101 (1945, *per* Frankfurter, J.) (*diversity*); Holmberg v. Armbrecht, 327 U. S. 393 (1946, *per* Frankfurter, J.) (*nondiversity*); Textile Workers Union v. Lincoln Mills, 353 U. S. 448 (1957, *per* Black, J.) (*N. B.* 353 U. S. *at* 474, 482-3, *per* Frankfurter, J., *dissenting*) (*nondiversity*).

The outcome was cancellation of many shares of stock of record, reduction of other shares, and increase of the remaining shares. Thereby, the Court below erred: (a) *Executed* contracts—which had vested property rights under state law—were rejected, and property was divested, although executory (*i.e.*, unexecuted) contracts *only* may be rejected under the Bankruptcy Act[45] and the Fifth Amendment.[46] (b) Stock was *cancelled*, though applicable Pennsylvania corporation law bars such a remedy here. (c) A *resulting trust* was impressed, though applicable New York and Pennsylvania rules of decision in equity bar such a remedy here.

The issues here—as pleaded, tried, and decided—involve *only* the rights of the stock-claimants, *inter se*, all equally innocent of wrongdoing, to share in the beneficial ownership of the Debtor's assets. Those rights were created by state law; and state law should govern their adjudication. The Debtor's counterclaims against all the stock-claimants for money judgments for the stock subscription price, were denied by the District Court. Neither the Debtor nor any other party appealed from the denial of the money judgments (by contrast to the award of stock); therefore, the denial of money judgments is now final, and the Debtor is a stakeholder in a contest among stock-claimants.

1. The Court below erroneously viewed the "basic issue" or "problem" in No. 27000 as the formulation of a plan of reorganization, not as the allowance of claims to stock interests:

> "Since the problem for the reorganization court is to decide upon the capitalization necessary *to do equity* in the light of the various claims before it, this

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[45] Bankruptcy Act, § 116(1); 11 U. S. C. § 516(1); 52 Stat. 885 (1938); *see* 6 Collier on Bankruptcy (14th ed.) ¶¶ 3.23, 3.24, 3.25.

[46] *See* Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555 (1935, *per* Brandeis, J.); Schaad v. Hotel Easton Co., 369 Pa. 486, 87 A. 2d 227 (1952, *per* Stern, J.).

> court need pass *only* upon the immediate question of *who should be stockholders of the reorganized debtor* and in what proportions. With these basic principles determined, the solution becomes more clearly defined. * * *" (*App.* 37a; emphasis supplied.)

The Chapter X court cannot reach the question, Who *shall be* the stockholders of the reorganized debtor at the close of the proceedings?—until it first decides the question, Who *were* the stockholders of the Debtor at the commencement of the proceedings? Every reorganization involves at least two distinct steps or stages: *first*, determination of its creditors and stockholders, by the *allowance of claims;* and *thereafter*, provision for participation of those creditors and stockholders in the debtor's assets, by formulation of a *plan of reorganization.*[47] The first stage—the allowance of claims—is the only stage this proceeding has reached. No plan of reorganization submitted by anyone is even pending before any court in these proceedings; and no issuance of stock in a "reorganized" debtor is properly before the courts.

2. The allowance of claims of creditors and stockholders in bankruptcy proceedings is normally governed by state law.

> "A purpose of bankruptcy is so to administer an estate as to bring about a ratable distribution of assets among the bankrupt's creditors. What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law. * * *"[48]

> "* * * We do not reach considerations of policy in bankruptcy administration until there are rights, created by applicable local law, to be recognized."[49]

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[47] *See* 6 Collier on Bankruptcy (14th ed.) ¶ 9.02[1].

[48] Black, J., *in* Vanston Bondholders Protective Committee v. Green, 329 U. S. 156, *at* 161 (1946).

[49] Frankfurter, J., *concurring, ibid.*, 329 U. S. *at* 171.

3. There is no "overruling federal law" or supervening bankruptcy policy applicable in No. 27000: No substantive or positive provision of the Bankruptcy Act or any other federal statute has been invoked or would be applicable here; the rights were not federally created, and this case is no occasion to "legislate interstitially" or to "fashion federal law" as to rights or remedies.[51] The bankruptcy scheme of distribution is irrelevant to a distribution among a single class of stockholders.[52] No federal agency is a party.[53] This is *not* a suit "by a receiver of an insolvent corporation to compel its *promoters* and their *confederates* to restore illicit gains."[54] Malakoff was the "sole-actor," and is not a party. No "inequitable *conduct*" or fraud by *any* of the stock-claimants has been found by the Court of Appeals or the District Court—nor is that the basis for the disallowances below.[55]

4. Absent such "overruling federal law," the *Erie* principle—"outcome-determinative"—should govern in this non-diversity case, no less than in a diversity case.[56] The "equi-

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[51b] *Cf.* McKenzie v. Irving Trust Co., 323 U. S. 365 (1945, *per* Stone, C. J.); Holmberg v. Armbrecht, *supra*, note 44; Schwabacher v. U. S., 334 U. S. 182 (1948, *per* Jackson, J.; Frankfurter, J., *dissenting*).

[52] *See* Prudence Realization Corp. v. Geist, 316 U. S. 89 (1942, *per* Stone, C. J.).

[53] *See* Bank of America Nat. Tr. & Sav. Assn. v. Parnell, 352 U. S. 29 (1956, *per* Frankfurter, J.; Black, Douglas, JJ., *dissenting*); *cf.* D'Oench, Duhme & Co. v. F. D. I. C., 315 U. S. 447 (1942, per Douglas, J.; Frankfurter, Jackson, JJ., *concurring*).

[54] *Cf.* McCandless v. Furlaud, 296 U. S. 140, *at* 149 (1935, *per* Cardozo, J.) (*emphasis supplied*).

[55] *Cf.* Taylor v. Standard Gas & Electric Co. [*In re* Deep Rock Oil Corp.], 306 U. S. 307 (1939, *per* Roberts, J.); Pepper v. Litton, 308 U. S. 295 (1939, per Douglas, J.).

[56] *See* Erie R. Co. v. Tompkins, 304 U. S. 64 (1938, *per* Brandeis, J.); Guaranty Trust Co. v. York, *supra* note 44; *cf.* Fore Improvement Corp. v. Selig, 278 F. 2d 143 (2d Cir., 1960, *per* Moore, J.; Friendly, J., *concurring*); *see also* Hill, Erie Doctrine in Bankruptcy, 66 Harv. L. Rev. 1013 (1953); 3 Collier on Bankruptcy (14th ed.) ¶ 63.03[3]; 4 *id.* ¶¶ 70.04, *n.* 31; 70.15[2], *nn.* 22-25; 70.25[2], pp. 1222-5; 70.49; 70.70[2]; 70.78.

table remedial rights doctrine" is no license here; at stake is not mere practice.[57] The statutory *remedies* here cannot be separated from the statutory *rights* under state law. The Rules of Decision Act and the Federal Rules of Civil Procedure are applicable in bankruptcy: Congress has effectually codified this Court's decisions and mandated application of state rules of decision in *all* civil actions, whether formerly cognizable at law or in equity, and irrespective of the basis of federal jurisdiction, *unless* federal law "shall otherwise require or provide."[58] The proviso is as irrelevant here as if No. 27000 were a diversity case.

5. The Court of Appeals, by disallowing stock-claims, has effectually *cancelled stock* for lack of consideration to the Debtor. Judge Moore wrote:

> "* * * From these persons [disallowed] the Debtor did not receive and was not intended to receive anything of value, either from them or *from Malakoff*. These shares as a matter of Pennsylvania law could have had no validity as an original issue. * * *
>
> "Despite the cloud of illegality obscuring *any* stock issuance, the Debtor came into corporate being and did acquire a valuable property which it still holds. *The Market property is sufficient to support a valid stock issue* to those entitled thereto. The sellers (Philadelphia group) have been paid for that property *by Malakoff*. * * *" (*App.* 37a-38a; emphasis supplied.)

In other words, the Market was paid for by Malakoff, and is sufficient consideration under Pennsylvania law for the issuance of *new* stock for purposes of a plan of reorganization—but the Market is *not* sufficient consideration under Pennsylvania law for the issuance of *old* stock for purposes

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[57] *See* 2 Moore's Fed. Prac. (2d ed., 1961) ¶ 2.09.

[58] 28 U. S. C. § 1652, 62 Stat. 944 (1948); *see* Reviser's Note *thereto; and see* 6 Collier on Bankruptcy (14th ed.) ¶ 1.17; 1A Moore's Fed. Prac. (2d ed., 1961) ¶¶ 0.305[3], 0.325; Mason v. U. S., 260 U. S. 545 (1923, *per* Sutherland, J.).

of the allowance of claims![59] No reason is given—and there is no reason—why the Market (never appraised) should not have been sufficient in *value* to support a valid stock issue—old or new—to *all* the stock-claimants.

But even assuming the invalidity of the stock: The Court below completely disregarded the *exclusive remedy* spelled out by Pennsylvania statute. That disregard was more than an erroneous interpretation of state law; it was an affirmative choice of "federal equity," and a holding that the state remedy was irrelevant.

The Pennsylvania Business Corporation Law provides:

> "§ 610. Validity of Shares.—The fact that shares are issued in violation of, or without full compliance with, the provisons of this act *shall not make the shares so issued invalid*, unless they are issued in violation of Article XVI, Section seven, of the Constitution of this Commonwealth."[60]

The Pennsylvania Constitution provides:

> "[XVI] § 7. No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * *"[61]

But the remedy is *not* cancellation of stock:

> "* * * However, the Pennsylvania cases are agreed that this constitutional provision [Art. XVI, § 7], standing alone, does not cause the issuance of stock without prepayment to be void. Rather, it is neces-

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[59] *See* Winston v. Saugerties Farms, Inc., 262 A. D. 435, 29 N. Y. S. 2d 292 (3d Dept., 1941, *per* Foster, J.), *aff'd.* 287 N. Y. 718, 29 N. E. 2d 934 (1942, *p. c.*); Schmidt v. Paul, 377 Pa. 377, 105 A. 2d 118 (1954, *per* Stearne, *J.*).

[60] Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P. L. 364, Art. VI, § 610 (1933) (*emphasis supplied*).

[61] Pa. Const., Art. XVI, § 7 (1874, 1956).

sary that the legislature shall *implement* the constitutionally stated policy by a statute declaring the nature and extent of any infirmity which attaches to the stock so issued, and *what may be done about it.* [Pa. cases.]" [62]

The Pennsylvania Business Corporation Law has "implemented" the Pennsylvania constitutional policy, in detail. The remedy for lack of consideration to the corporation for stock issued, is *assessment* or call—collectible like any other debt, and secured by a lien on the shares themselves.[63] Cancellation may be effected *only* after foreclosure of the corporate lien on the stock, and then *only* if public sale brings no purchase or if the corporation fails to collect a money judgment for the deficiency.[64] Assignees and transferees of subscriptions (as well as issued shares) are exonerated from assessment if their acquisitions were made "in good faith and without * * * notice" of the failure of consideration.[65] The corporation's foreclosure of any lien on the stock—including a lien for the subscription price—is barred where (as here) the stock certificates issued by the corporation bear no statement asserting such a lien.[66]

The Chapter X summary proceedings afforded the Debtor the same opportunity as a local action to obtain the relief prescribed by Pennsylvania law, namely: assessment, pre-

[62] Hastie, J., *in* Grafton v. Masteller, 232 F. 2d 773, *at* 775 (3d Cir., 1956), *cert. den.* 352 U. S. 832 (1956) (*Pa. forum; diversity jurisdiction; emphasis supplied*).

[63] Pa. Bus. Corp. L. §§ 604, 605, 609; 15 Purdon's Pa. Stats. Ann. §§ 2852-604, 605, 609; P. L. 364, Art. VI, §§ 604, 605, 609 (1933).

[64] *Ibid.*, § 605.

[65] *Ibid.*, § 609.

[66] 15 Purdon's Pa. Stats. Ann. § 315; P. L. 120, § 15 (1911) (*identical to* Uniform Stock Transfer Act, § 15) (*repealed and replaced by* 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] §§ 8-103, 8-204; P. L. 3, §§ 8-103, 8-204 [1953], *effective* July 1, 1954); *see* Bubbis v. Duffy & Bros., Inc., 14 Pa. D. & C. 281 (C. P., Phila., 1930, *per* Alessandroni, J.).

requisite to cancellation. The Debtor could—and did—sue the stock-claimants (who had appeared generally) for the allegedly unpaid subscription price. Liability to assessment is altogether a matter of Pennsylvania law.[67] Absent appeal, the District Court's denial of assessment is *res judicata*.[68] Whatever relief the parties may now have, that relief cannot be cancellation of stock.

6. Having cancelled all the outstanding stock (despite the Pennsylvania law), the Court of Appeals then impressed a *purchase-money resulting trust*. What began as a distribution of the *Debtor's* assets, finished as a distribution of *Malakoff's* assets. Judge Moore wrote:

> "* * * The sellers (Philadelphia group) have been paid for that [Market] property by Malakoff. Malakoff in turn obtained the money *for this purpose* from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a trustee, fiduciary, agent, promoter or syndicator (the terminology is unimportant—the facts create the rights) *for those who gave him their funds for investment in the project.* They should in equity receive that for which they paid." (*App.* 38a-39a; emphasis supplied.)

Applicable state law bars such a remedy. For the rules of decision in *equity* in both New York and Pennsylvania—binding in diversity cases[69]—preclude the resulting trust impressed below.

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[67] Harrigan v. Bergdoll, 270 U. S. 560 (1926, *per* Brandeis, J.); *see* 4 Collier on Bankruptcy (14th ed.) ¶ 70.29[2].

[68] *See* Angel v. Bullington, 330 U. S. 183 (1947, *per* Frankfurter, J.).

[69] Ruhlin v. N. Y. Life Ins. Co., 304 U. S. 202 (1938, *per* Reed, J.); Cities Service Oil Corp. v. Dunlap, 308 U. S. 208 (1939, *per* McReynolds, J.).

In *New York*, resulting trusts have been abolished altogether.[70] What remain are the *express trust* (subject to the statute of frauds) and the *constructive trust* (or "implied" or "fraud-rectifying" trust).[71] An express trust or a constructive trust here would have allowed the prevailing stock-claimants *precisely* "that for which they paid" (*App.* 39a)—*e.g.*, in Weinstein's case, 7/200 or 3.5% under his letter-receipt from Malakoff, instead of 4.79% as awarded to him below.

In *Pennsylvania*, resulting trusts, though not abolished, have been severely curtailed by statute and case-law. A purchase-money resulting trust could operate here in favor of an "investor" *only* if his advances had been made to Malakoff *before* Malakoff had paid the purchase price of the realty to the Philadelphia Group. *Subsequent* advances, even if used for improvement of the realty or for satisfaction of liens on the realty, would at most give the "investor" an equitable lien for recovery of his "investment"—but *not* equitable ownership of the realty.[72] Here, Malakoff is said to have paid the Philadelphia Group a total of $77,010.84, and to have received a total of $79,025 from "investors", all *before* February 15, 1952 (*App.* 35a). Yet, "investments" aggregating $145,987.34— almost half advanced *after* that date—have been allowed (*App.* 40a-41a, 45a). Under Pennsylvania law, those later "investors" *cannot* be *cestuis* of a purchase-money

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[70] N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) §§ 91, 94.

[71] Fraw Realty Co., Inc. v. Natanson, 261 N. Y. 396, 185 N. E. 679 (1933, *per* Kellogg, J.); *In re* Cohen's Estate, 137 N. Y. S. 2d 300 (Sup., N. Y., 1954, *per* Walter, J.), *affd.* 285 A. D. 1119, 141 N. Y. S. 2d 819 (1st Dept., 1955), *affd.* 309 N. Y. 935, 132 N. E. 2d 311 (1955).

[72] Musselman v. Myers, 240 Pa., 5, 87 A. 425 (1913, *per curiam*); Farmers Trust Co. v. Bevis, 331 Pa. 89, 200 A. 54 (1938, *per* Drew, J.); Majors v. Majors, 349 Pa. 334, 37 A. 2d 528 (1944, *per* Hughes, J.). *Accord*: Olcott v. Bynum, 84 U. S. 44 (1873, *per* Swayne, J.).

resulting trust. Likewise, they *cannot* be "good-faith purchasers": [73] In purchasing the realty, Malakoff is said to have acted for the "investors", not for himself or the sellers (*App.* 39a); therefore, the later "investors" are charged with *notice* of Malakoff's wrongdoing.[74] Under Pennsylvania law, their claims are entitled to no better standing than the stock-claims which were disallowed below because consideration was "antecedent indebtedness".

Thus, the peculiar resulting trust impressed below—advocated by Weinstein and Fried in their joint briefs below, and barred by both New York and Pennsylvania law—is the sole "equitable" device which can penalize 6 stock-claimants, while enriching 30 others, for Malakoff's individual wrongdoing—of which all 36 have been found equally innocent.

7. The primary issue here is whether federal or state law applies. A conflict of laws between the applicable New York and Pennsylvania rules of decision as to resulting trusts, would require a choice of state law by a federal court in a nondiversity case—a matter expressly left unsettled by this Court at least three times since *Erie*.[75]

* * *

The foregoing discussion has assumed (*arguendo*) that the Court of Appeals' statement of facts was correct. However, its statement of facts was *not* correct. The major errors (among many) were: (1) *tracing* of the purchase price of the Market, thus setting aside the District Court's finding of *no-tracing;* and (2) *intention* of the prevailing stock-claimants to deal with Malakoff in a *fiduciary* capacity,

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[73] 21 Purdon's Pa. Stats. Ann. § 601; P. L. 425, § 1 (1901).

[74] Curtis, Collis & Holbrook Co. v. U. S., 262 U. S. 215 (1923, *per* Taft, C. J.).

[75] D'Oench, Duhme & Co. v. F. D. I. C., *supra* note 53, 315 U. S. *at* 456; McKenzie v. Irving Trust Co., *supra* note 51, 323 U. S. *at* 371, n. 2; Vanston Bondholders Protective Committee v. Green, *supra* note 48, 329 U. S. *at* 162. *Cf.* Klaxon Co. v. Stentor Electric Mfg. Co., Inc., 313 U. S. 487 (1941, *per* Reed, J.). *See* Goodrich, Two States and Real Estate, 89 U. of Pa. L. Rev. 417 (1941).

thus setting aside the District Court's finding that *all* 36 stock-claimants intended to deal with Malakoff in his individual capacity as stockholder-seller. The appellate substitution of findings, of course, was essential to the impression of a purchase-money resulting trust. (The conclusiveness of the District Court's findings of fact under Rule 52(a),[76] is the principal subject of the unsuccessful petition for rehearing of No. 27000 below [No. 27000: R 42a].)

The District Court's findings were not "clearly erroneous"; indeed, they were the only reasonable findings of fact on the evidence. In substituting its own findings of fact, the Court of Appeals has committed an egregious violation of Rule 52(a) and has acted outside the proper scope of appellate review. Thereby, the Court of Appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

* * *

In sum: It was a veritable fortuity that No. 27000 should have been litigated in a bankruptcy court at all. No reason, no law, and no equity should differentiate between the adjudication of the stock-claims in a federal reorganization court and the adjudication of the stock-claims in a state court (or in a federal court with diversity jurisdiction). The Chapter X court is bound to follow state law in determining the rights of the stock-claimants *inter se* to share in the Debtor's assets. The applicable *state* law, disregarded below, bars the remedy below. The principal *federal* law applicable is procedural—Rule 52(a)—which the Court of Appeals also disregarded. Assuming to act without the guidance of any federal or state statute or policy, the Court of Appeals has engaged in an exercise of naked power based on subjective notions of "equity." The "chancellor's foot," as a federal standard, was part of the "brooding omni-

[76] Rule 52(a), Fed. Rules of Civ. Proc., *f.* 28 U. S. C. § 2072.

presence" outlawed by *Erie*. This Court thereby formulated a new "way of looking at law" [77]—which should apply irrespective of the jurisdictional ground.

Conclusion

In No. 26362, the Court below applied state rules of decision to a federal question—the administration during reorganization of an estate in the custody of a federal court. In No. 27000, the Court below applied federal rules of decision to a state question—the allowance of claims to stock interests which had vested under state law prior to reorganization. The questions involved in No. 26362 and No. 27000—what rules of decision are applicable in Chapter X proceedings (and other nondiversity cases)—are related, recurrent, and important, and should be settled by this Court.

For the reasons set forth above, it is respectfully submitted that this Petition for Writs of Certiorari should be granted.

Dated: New York, New York
February 21, 1962

MELVIN LLOYD ROBBINS,
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[77] Guaranty Trust Co. v. York, *supra* note 44, 326 U. S. *at* 101.

Appendix A

Opinion Below in No. 27000

(Argued August 17, 1961—Decided November 9, 1961.)

Before: MOORE, FRIENDLY and SMITH, *Circuit Judges*.

Appeals in Docket No. 27000 from an order made on December 8, 1960 (Sugarman, *D.J.*) in a Chapter X, Bankruptcy Act, proceeding in the United States District Court for the Southern District of New York, resolving the stock interests in the Debtor of 36 claimants. Order reversed except as specified in opinion.

Appeals by the Debtor and J. Fried in Docket No. 26962 from an order made on April 10, 1961 (Sugarman, *D.J.*) in a Chapter X, Bankruptcy Act, proceeding in the United States District Court for the Southern District of New York, granting a petition to reopen proceedings in connection with petitions to review an order of a Referee in Bankruptcy made October 5, 1957, disallowing stock claims of 5 claimants and to receive in evidence in support of such petitions to review, the minutes of all hearings relating to the stock claimants in Docket No. 27000 and to take further testimony. Order affirmed as to reception of so much of the minutes as does not concern evidence peculiar to the claimants concerned in Docket No. 27000; otherwise reversed. On the petitions to review the order of the Referee in Bankruptcy, the district court is directed to modify the order of October 5, 1957, in accordance with this opinion.

MOORE, *Circuit Judge*:

The two cases (Nos. 26962 and 27000) consolidated on this appeal both involve the resolution of stock claims in Nazareth Fairgrounds & Farmers Market, Inc. (the Debtor), a corporation being reorganized under Chapter X of the

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Bankruptcy Act. No. 26962 involves five stock claimants (54 shares) and is an appeal from an order of the District Court which reopened the proceedings on a petition to review a decision of the Referee denying the stock claims of the five claimants therein. No. 27000 is an appeal from an order of the District Court settling and allowing the stock claims of the thirty-six claimants (262 shares) therein.

The Debtor was organized on August 7, 1951, as part of a plan to transfer the ownership of a farmers' market in Nazareth, Pennsylvania, a parcel of some 32 acres and buildings, from a group consisting of Edward Malakoff, Maurice Malakoff, Milton Zoloth and Morris Soble (the Philadelphia Group) to John Malakoff (Malakoff). Previously thereto on April 17, 1951, the Philadelphia Group through a controlled corporation, Richard Realty Co., purchased this property from its then owner, Nazareth Fairgrounds, Inc., for $66,000. John Malakoff had one-quarter interest in the original purchase of the property by the Philadelphia Group. On May 14, 1951, for corporate and tax reasons Richard Realty Co. conveyed the property subject to mortgages to Kipling Realty Co. (also a Philadelphia Group controlled corporation) for $100.

In July, 1951, John Malakoff orally agreed (so found by Examiner and trial court) to purchase the Philadelphia Group's interest in the property for $66,000 plus an undetermined amount, alleged to have been $30,000. The Articles of Incorporation of the Debtor which were executed on August 1, 1951, provided for an authorized capital of 200 shares with a stated capital applicable thereto of $120,000. The first meeting of the directors of the Debtor authorized the purchase of the Nazareth property from Zoloth and Soble for twenty shares of the corporation's stock and the assumption of all obligations by the corporation, including amounts shown as loans payable to the Philadelphia Group. About August 8, 1951, stock certificate #1 for 10 shares was issued

to Milton Zoloth and certificate #2 for 10 shares was issued to Morris Soble. On October 17, 1951, a contract was executed between John Malakoff and Zoloth and Soble whereby Malakoff purchased their 20 shares of stock for $32,853.08; $2,853.08 was paid on execution of the contract and the remaining $30,000 was to be paid in 10 monthly installments of $3,000. Title to the stock was to pass on the execution of the contract but the stock was to be held in escrow until the payment of the $30,000. On October 17, 1951, Zoloth endorsed stock certificate #1 over to Malakoff and on October 22, 1951, Soble endorsed certificate #2 to Malakoff. On June 17, 1953, Malakoff endorsed these certificates over to the Debtor, and executed a release of all claims against the Debtor.

The certificates and corporate books were not turned over to Malakoff until December, 1952, although he had been managing the business since October, 1951.

In April, 1951, Malakoff started to solicit investments in the Nazareth enterprise, promising investors a 20% return on their capital. Generally, shares were offered at a rate of $1,000 a share, although some investors paid only $600 a share.

Between April 1, 1951, and February 15, 1952, Malakoff received from investors in the Nazareth venture $79,025 and paid to the Philadelphia Group $77,010.84; the latter figure includes $11,032.84 received in payment of an insurance claim for windstorm damage. However, at no time did the amount that John Malakoff paid to the Philadelphia Group exceed the amount which he had already collected from investors. Until he became insolvent in June, 1953, Malakoff paid monthly "dividends" to the investors based on a 20% annual return on their original investments. These "dividends" were paid in Ponzi-like [1] manner out of new money received

[1] See *Cunningham* v. *Brown*, 265 U. S. 1 (1924).

from investors in the Nazareth Market. The corporation did not have a profit from which dividends could have been paid during this period. Shares of stock were issued to the claimants herein on and after February 2, 1953, and none can be said to have been issued in a regular manner, that is, upon receipt of consideration passing directly to the Debtor. Moreover, the consideration for which the stock in Nazareth was issued was not the same in all cases: some investors gave Malakoff cash or checks; others received their interest in Nazareth by releasing funds which Malakoff held for them as proceeds from other ventures; others accepted Nazareth stock from Malakoff in exchange for stock in other Malakoff ventures that had proved worthless; and some of the claimants received interests in Nazareth in satisfaction of Malakoff's personal debts to them. In substantially all cases the certificates were not issued to the stock claimants at or about the time they allegedly gave consideration to Malakoff as an investment in Nazareth. Altogether 316 shares were issued, 116 more than were authorized, to the 41 claimants herein. On September 28, 1953, the Debtor filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act. To achieve a reorganization of the Debtor which, insofar as stock issuance and ownership are concerned, never had been properly organized, the trial court had to determine as a basic issue: who, if any, were entitled to participate in the stock of the reorganized Debtor. The Court referred the task of making this investigation to an Examiner (Bankruptcy Act of 1898, §§ 167, 168; 11 U. S. C. A. 567, 568). Testimony (some 10,000 pages) was taken concerning the circumstances under which the stock claimants had purportedly invested in the Nazareth Market or claimed to be entitled to participate as stockholders of the Debtor. In a detailed and painstaking report (236 pages), the Examiner carefully sifted the issues fundamental to the resolution of stock participation.

Appendix A

In summary, he found that every claimant had acquired his or her stock by means of transactions with Malakoff or his agents; that none of the consideration therefor passed directly to the Debtor; that Malakoff and the claimants "ascribed little or no importance to the legal form which the venture took, or to the observance of the legal and other formalities and requisites of its corporate form"; that not one of the claimants "has a clear legal right to any of the shares which he or she claims"; and that he (the Examiner) should "apply equitable principles in the determination of who are the stockholders of the debtor and what proportions of its stock they hold."

Since the problem for the reorganization court is to decide upon the capitalization necessary to do equity in the light of the various claims before it, this court need pass only upon the immediate question of who should be stockholders of the reorganized debtor and in what proportions. With these basic principles determined, the solution becomes more clearly defined. One group of investors paid Malakoff by check, credit or cash various sums to purchase an interest in the Nazareth Market. The money was solicited for this purpose by Malakoff as the promoter of the enterprise and was not intended to be loans to Malakoff personally or to be used generally by him in his many business operations. The funds should have reached the Debtor's treasury and have been the consideration required by Pennsylvania law[2] to support the valid issuance of the Debtor's shares. The other group consists of persons to whom Malakoff issued shares for antecedent personal debts, in exchange or substitution for shares of other ventures or for other obligations personal to Malakoff. From

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[2] "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void." Pa. Const. art. XVI, § 7, implemented in 15 Purdon's Pa. Stat. § 2852-603(A) (1958).

these persons the Debtor did not receive and was not intended to receive anything of value, either from them or from Malakoff. These shares as a matter of Pennsylvania law could have had no validity as an original issue. In many instances, however, Malakoff gave by assignment to persons in this group shares purportedly issued to him. Had these shares been validly issued to Malakoff then, but only then, would the principles of the Uniform Stock Transfer Act [3] in force in Pennsylvania at the time of the transactions here involved as to consideration and "value" apply. But no such shares were ever validly issued to Malakoff. The 20 shares originally issued to Zoloth and Soble, although subsequently assigned to Malakoff and still later by him to the Debtor, did not come into the hands of any claimant. After the shares had been issued to the claimants from and after February 2, 1953, corporate minutes in May or June, 1953, were fraudulently prepared and pre-dated as of July 2, 1952 (or post-dated as of July 2, 1953) purporting to evidence the issuance of the remaining 180 shares to Malakoff for $75 a share. There is no proof that Malakoff ever paid for these shares or that they were legally issued. Thus no claimant can derive any rights by assignments from Malakoff on the theory that he was the owner of the Debtor's stock. The purported issuance was both fraudulent and invalid.

Despite the cloud of illegality obscuring any stock issuance, the Debtor came into corporate being and did acquire a valuable property which it still holds. The Market property is sufficient to support a valid stock issue to those entitled thereto. The sellers (Philadelphia group) have been paid for that property by Malakoff. Malakoff in turn

[3] "'Value' is any consideration sufficient to support a simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a certificate is taken either in satisfaction thereof or as security thereof." Uniform Stock Transfer Act § 22(1), 15 Purdon's Pa. Stat. § 322, now covered by Uniform Commercial Code § 8-303, 12 A Purdon's Pa. Stat. § 8-303 (1958).

obtained the money for this purpose from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a trustee, fiduciary, agent, promoter or syndicator (the terminology is unimportant—the facts create the rights) for those who gave him their funds for investment in the project. They should in equity receive that for which they paid.

Although the findings of fact of the Examiner may be accepted almost in their entirety, his conclusions are at variance with the equitable principles applicable here. The Examiner treated Malakoff as the owner and operator of the Debtor and each claimant as having purchased his interest from Malakoff. This erroneous assumption made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory that stock transfers from Malakoff rested upon adequate consideration if the Stock Transfer Act's definition of "value" were satisfied. This, however, is not the problem. The Debtor's stock for all practical purposes has never been legally issued. Such stock as is to be issued in the reorganization should be based upon the requirements of Pennsylvania law with respect to the issuance of stock.[4]

Malakoff received the moneys put into his hands by the investors for the specific purpose of the allotment of shares in the Nazareth Market property. He used some of this money to acquire that property. Title thereto now is in the Debtor. The court upon reorganization is in a position to give to the investors that which they were originally entitled to receive.

At the time Malakoff obtained the investors' funds, he spoke in terms of the issuance of shares. To some he promised shares at $600; to others at $1,000. Although

[4] See footnote "2," *supra*.

shares were purportedly issued, the "dividends" of 20% were paid and accepted on the basis of the amount invested. Greater equity will be achieved by calculating the allowed claims in terms of dollars rather than in invalidly issued shares. The "investors" had a right to expect that the sums delivered to Malakoff would represent their shares in the enterprise and would be delivered to the corporation. Therefore, in determining their interests the entire amount paid, undiminished by any so-called "dividends," must control their participation.

As to the stock claimants, with few exceptions they fall into two distinct categories: (1) those investors who paid for a participation in the Nazareth Market by cash, check or credit, and (2) those who did not make any payment but who rely upon antecedent indebtedness of Malakoff and other transactions with him unrelated to the Nazareth venture as consideration.

In the first category are the claimants listed below whose claims should be allowed in the amounts indicated. As to these claimants, the findings of the Examiner and the trial court relating to the amounts paid to Malakoff and the circumstances under which they were paid are affirmed.

Name	*Amount*
Charles Kanter	$ 4,000.00
Morton Samet	2,000.00
Gertrude Klein	14,000.00
Dorothy Holober Clark	3,000.00
Barry Clark	4,000.00
Harold Q. Masur	4,000.00
Louis Como	6,000.00
Frank Como	6,000.00
Patsy Como	8,000.00
Anne Bikales	5,000.00
Lawrence Treat	2,000.00
Dorothy Kane	3,000.00

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Miriam Klein	3,350.00
Ruth Spielholz	3,000.00
Mae Bluestone	2,000.00
Gussie Schwartz	2,000.00
Harold B. Schwartz	4,000.00
Lazar Karapantso	2,000.00
Ernest Pollak	9,000.00
H. Lawrence Laupheimer	7,750.00
Arnold A. Weinstein	7,000.00
Aaron Fried	3,000.00
George Bond	1,000.00
Tess J. Schwartz	3,000.00
Cydney Grosman	2,000.00
Rose Kaplan	1,000.00
Robert A. Noire	5,000.00
Richard S. Hull	3,600.00
Leslie Saul	3,000.00
Jerome Fried	2,000.00
Ann Rosen	6,000.00

Charles Kanter

As to the claimant, Kanter, there must be some modification of the Examiner's and trial court's conclusions. The Examiner found that after Malakoff in early 1951 had agreed to take a one-quarter interest in the Nazareth Market for $16,000, Kanter took one-quarter of this amount for $4,000 and gave Malakoff a check for $2,667 and cash or customers' checks for $1,333.33. Although Malakoff's promissory note for $4,000, dated April 11, 1951, signed as "Agent," is somewhat in conflict with the investment theory, nevertheless it is endorsed "For 1/16th of interest in Nazareth Market." Therefore, $4,000 may properly be placed in the investment category. The balance of Kanter's claim falls into the second category and must be disallowed.

In the second category are the claims which must be disallowed.

Herbert and Melvin Danciger

The Dancigers' claim is based upon a certificate for 11 shares given to them by Malakoff to secure a personal obligation arising out of a real estate operation unrelated to the Nazareth Market. The entire claim must be disallowed.

Seymour Forman

This claim to 15 shares is based upon a certificate for 15 shares issued in Malakoff's name and endorsed by him to Forman. Even this claimant does not contend that he intended to invest in Nazareth. At most, the shares (invalidly issued) were to secure loans. If Forman has a claim based upon a loan for $5,000, or any other amount, to the Debtor, it must be considered independently of any claim to a stock interest. The stock claim must be disallowed.

Eskandar Manoochehrian

This claim is based upon two certificates totalling 20 shares. The claimant himself states the consideration to have been a loan of $20,000 to a corporation other than the Debtor. The claim clearly comes within the second category and must be disallowed in its entirety.

H. Forman

The claim for 10 shares involves two certificates for 5 shares each dated March 13, 1953, and April 23, 1953, respectively. The Examiner found that "At that time there were no open transactions between Forman and Malakoff

and neither one owed the other any money"; that Forman delivered a check for $5,000 dated April 23, 1953, payable to Malakoff to cover Forman's agreement to buy 5 shares in the Nazareth project; that "It is perfectly plain that the transaction Forman had with Malakoff on or about the 17th day of March, 1953, was a security transaction so far as the Nazareth stock was concerned"; and that the second certificate "likewise seems to have been a security transaction despite Forman's testimony to the contrary." The April, 1953, payment of $5,000 for 5 shares is claimed to have been for an investment in Nazareth. However, the Examiner has found to the contrary on conflicting evidence and no showing has been made that such a finding is clearly erroneous. As a result, these facts place this claim in the second category and it must be disallowed.

Frederick Katzenell

Katzenell bases his claim upon an alleged Malakoff antecedent indebtedness of $28,000 and a $2,000 check given to Malakoff in September, 1951. The check, however, bears Katzenell's own notation of "loan." Neither the antecedent debt nor the loan support an investment in Nazareth and, hence, his claim must be disallowed.

Another group (the Margolis group) involved in a separate appeal (No. 26962) must be considered as potential participants. The Referee in Bankruptcy found no equity in favor of any claimant in this group, i.e., Benjamin Margolis (17 shares), William McK. Shongut (10 shares), Bernard Ungar (2 shares), Ida Margolis (15 shares) and Sarah Kason (10 shares).

Despite the fact that the Margolis appeal relates directly only to the district court's order permitting a reopening of the proceedings as to this group, there is sufficient proof before this court to enable us to indicate our views as to the rights of these claimants.

Appendix A

The claims of three of the five claimants in appeal No. 26962, Benjamin Margolis, Bernard Ungar and Sarah Kason, should be completely disallowed. These claims are based on certificates which were issued in satisfaction of Malakoff's personal debts or to replace worthless stock in other Malakoff ventures. The claims of William McK. Shongut and Ida Margolis should be allowed in part.

Benjamin Margolis

Benjamin Margolis claimed 17 shares, purchased in units of 10 and 9 (2 of the latter group were sold to claimant Ungar). For the former group, the consideration was debts owed personally by Malakoff to Mr. and Mrs. Margolis. For the latter, Margolis turned over shares in Wales Properties, Inc. (another Malakoff venture), specifically found by the Referee to be worthless. All of Margolis's claims should, therefore, be denied.

Berngrd Ungar

Ungar gave Margolis $2,000 for two shares of Margolis's stock. Since this stock was never validly issued to Margolis, Ungar could obtain no better rights thereto. His only remedy is against Margolis.

Sarah Kason

Sarah Kason, Ida Margolis's mother, held 10 shares. The Referee found that these shares were issued as security for money previously loaned to Malakoff personally by Ida Margolis, despite the fact that Mrs. Margolis claims the loans to have been to Nazareth. This finding appears reasonable and, therefore, the Kason claim should be denied.

William McK. Shongut

Shongut's 10 shares were acquired pursuant to an alleged agreement with Margolis whereby he delivered to Margolis,

as attorney, his check for $10,000. Margolis deposited this check in his bank account and Margolis guaranteed Shongut an income on the stock of 20% a year for 6 years. Shongut actually had given this $10,000 to Margolis for investment in Nazareth. However, Margolis only gave by checks and cash $6,287.34 to Malakoff. Shongut, therefore, should be allowed $6,287.34; for the rest he must look to Margolis.

Ida Margolis

In 1951 Ida Margolis paid to Malakoff $9,000 for 15 shares. This amount should be treated in the same manner as the allowed claims in appeal No. 27,000. The remainder of her claim, however, is based on stock issued to her in payment of a personal debt of Malakoff and, therefore, must be disallowed.

All Margolis group claims should be disallowed except those of Ida Margolis for $9,000 and Shongut for $6,287.34, which should be allowed.

There remains for consideration the proper treatment which should be accorded the "dividend" payments. Moneys paid by investors, which should have been turned over to Debtor but were diverted to persons whose stock claims are disallowed, belonged in equity to the Debtor. However, the rights of the Debtor with respect to such recoupment, if any, as may be just and proper, are not within the issues on this appeal. Insofar as "dividend" payments were made to and received by claimants whose claims are allowed, the sums were obviously not dividends because there were no earnings to support such payments. They could therefore only be regarded as distributions out of the Debtor's capital. The amounts received as found by the trial court should be a charge against any distributions to be made to these stockholders and any shares issued upon reorganization so

endorsed or stamped as to indicate this liability to subsequent purchasers or transferees.

This opinion deals with the rights of the original recipients of Nazareth stock. There have been some transfers, including those noted in Docket No. 26,362 decided simultaneously herewith, dealing with certain purchases and sales by claimants, Weinstein and J. Fried. The conclusions in this opinion are without prejudice to such action as equitable principles may require with respect to these two claimants or others who have bought or sold stock.

Appellants' contention in No. 26,962 that the district court could not open the petition for review and receive new evidence, including the minutes of the hearings on the stock claims involved in appeal No. 27,000, is without merit. General Order No. 47 gives the district court the right[4] to receive further evidence after receipt of a referee's report.[5] The necessity for such a rule is demonstrated by the facts presented in this case. The Referee's decision, that none of the claimants could recover because none of them gave consideration which passed directly to the corporation, was wrong. In order to make an equitable determination of the claims presented by these five claimants, the district court deemed it necessary (probably for comparative purposes) to consider the factual basis for the allowance of the claims of the other claimants. In view of our disposition of the claims in Docket No. 27,000 and our views as to the claims in Docket No. 26,962 further evidence beyond that already available to the court would seem to be unnecessary.

This reorganization has been pending for over eight years. The Farmers Market appears to be a currently profitable operation. A rapid termination of the proceeding would be in the interest of the claimants and the courts, thus giving

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[5] *In the Matter of Kaufhold*, 3rd Cir., 1958, 256 F. 2d 181; *Powell v. Wumkes*, 3rd Cir, 1942, 142 F. 2d 4.

to those who some ten years ago thought that they were investing in the Market that which they should have received at the time.

The order in =27,000 is reversed except as specified in this opinion. The order in =26,962 is affirmed as to reception of so much of the minutes as does not concern evidence peculiar to the claimants in =27,000; otherwise, reversed. On the petitions to review the order of the Referee in Bankruptcy, the district court is directed to modify the order of October 5, 1957, in accordance with this opinion. No costs in Dockets =27,000 and =26,962.

Rehearing of No. 26962

The petition for rehearing is denied.

The value, if any, of the Wales stock is immaterial. At most, the nine shares of Nazareth stock claimed by Benjamin Margolis were issued as an exchange and not for an investment in Nazareth. As to the Sarah Kason stock, the use to which Malakoff put the loan (i.e., payment of "dividends" to Nazareth "stockholders") does not change the loan to legal consideration for the issuance of Nazareth stock.

December 22, 1961.

Appendix B

Opinion Below in No. 26362

(Argued August 17, 1961—Decided November 9, 1961.)

Before: MOORE, FRIENDLY and SMITH, *Circuit Judges*.

Weinstein, president of the debtor, and Fried, its general manager, appeal from so much of an order of the District Court for the Southern District of New York, Sidney Sugarman, *J.*, as prohibited Weinstein from having anything further to do with the operation of its business and discharged Fried from its employ, approved the election of one Philip as director and treasurer, prohibited disbursal of funds except on Philip's countersignature, and authorized Philip to supervise the debtor's affairs pending employment of a new general manager. Wolf and other stockholders cross-appeal from so much of the order as failed to order Weinstein and Fried to reimburse compensation and expense moneys already received. Reversed on Weinstein's and Fried's appeal save for approval of election of directors and officers; affirmed on cross-appeal.

FRIENDLY, *Circuit Judge*:

The skeins from which Nazareth Fairgrounds & Farmers' Market, Inc. (hereafter Nazareth) began, and the lengthy efforts to unravel them, are recounted in my brother Moore's opinion in Nos. 27000 and 26962, this day decided. The instant appeals relate to a chapter in the Nazareth epic which, if scarcely modern, is at least more recent. The principal issue is the applicability to an officer and to a general manager of a debtor in possession, who have been receiving compensation pursuant to § 191 of the Bankruptcy Act, of Section 249, which provides:

> "Any persons seeking compensation for services rendered or reimbursement for costs and expenses in-

> curred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred."

We hold the section inapplicable.

Nazareth filed its petition for reorganization under Chapter X in September, 1953. Weinstein was then its president and Fried general manager.[1] The petition prayed that the "petitioner by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of your petitioner." The Court left the debtor in possession and authorized it to pay $100 a week to Fried, then described as secretary-treasurer, and nothing to Weinstein. Later the salary of Fried, then described as general manager, was increased, first to $150 and then to $200 a week, and Weinstein was awarded compensation of $50 a week. Fried, who is located at Nazareth, Pa., has been in active charge of the day-to-day operations of the debtor; Weinstein, a New York attorney, has made regular inspection trips and has passed on leases and other general policy matters. The administration has been successful, gross business having tripled from 1953 to 1959 and profits having risen from zero to $41,269.

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[1] Fried had previously been a director and secretary-treasurer; he resigned these offices on June 29, 1953.

Appendix B

In the course of administration a bitter contest for control arose between the stockholders who had elected Weinstein and Fried and an opposition group with which appellees are identified, known as the Rehrig group, Rehrig being a tenant of the debtor. In August, 1958, an election of directors was held, at which Weinstein, Herbert Danciger (not in either group), and Philip (Rehrig's attorney) were elected; they thereupon chose Weinstein as President, one Laupheimer as Vice President, Danciger as Secretary, and Philip as Treasurer. All this was subject to the Court's approval, as required by § 191; among the welter of petitions in this proceeding was one, verified August 6, 1958, but not decided until June 14, 1960, asking for that.

In March, 1959, appellees submitted a "Petition for Termination and Recoupment of Compensation (Pursuant to § 249 of the Bankruptcy Act)." The petition alleged that Weinstein's sister had purchased six shares of the debtor's stock in 1957; that in 1958 and 1959 Weinstein had purchased three shares, and sold a fraction of one; that in 1959 he or persons represented by him had exercised options to purchase six shares; that Fried had bought twenty shares in 1957 of which he had sold ten back to the vendor in 1958; and that these transactions violated § 249 and required the termination of appellants' compensation and the return of salary and expense moneys previously received. Weinstein filed an answering affidavit disclaiming responsibility for his sister's purchase and taking the position that his own purchases were made from stockholders who had tired of the long delays and insisted on selling to someone despite Weinstein's advice that they keep their stock—also that as to most of the stock, he was buying pursuant to options which had been arranged, in order to prevent a "raid" by Rehrig, on a basis that might result in others participating in the purchase nominally being made by him. He alleged also "that until now I was not aware of section 249 of the Bankruptcy Act," although conceding that he was "chargeable with knowledge of its

provisions." This was followed, a month later, by an order requiring appellees to show cause why their petition should not be dismissed pursuant to F. R. Civ. Proc. 12(b), with leave to appellants to answer in the event of denial.

The Court sent the matter to a referee for hearing and report; Referee Joyce recommended that the motion to dismiss be granted. When his report came before the District Judge in January, 1960, the judge filed a memorandum disapproving the Referee's ruling and setting a hearing for proof bearing on "recoupment" of past compensation and expense moneys. Such a hearing was held on June 14; at its conclusion, the judge directed from the bench that Fried be discharged as general manager, that Weinstein have nothing further to do with the operation of debtor's business, that the prayer for "recoupment" be denied, that the election of directors and officers be approved, that no funds should be disbursed save on Philip's countersignature, and that Philip should supervise the debtor's affairs pending the early appointment of a new general manager. Weinstein and Fried appealed from all of the order save for the denial of "recoupment" and so much of the approval of the election as did not relate to Philip; appellees cross-appealed from the former. On motion of Weinstein and Fried, offering to serve without compensation unless the order should be reversed, this Court, on July 12, 1960, stayed so much of the order as removed them from participation in the debtor's affairs and designated Philip in their stead, with leave to the District Judge to file more detailed findings of fact and conclusions of law. These make plain that "Weinstein's and Fried's dissociation from the management" of the debtor was directed "solely because they, as fiduciaries, violated section 249 of the Bankruptcy Act by dealing in the debtor's stock."[2]

[2] The judge had previously said orally at the hearing on June 14, 1960, that "in view of the Court's disposition of the petition for termination of compensation to Messrs. Weinstein and Fried, they can no longer function in their respective offices * * *"

When granting the stay, we had supposed the appeals would be heard in the fall of 1960; however, they were not argued until a special sitting on August 17, 1961. On Weinstein's and Fried's appeal we reverse, save as to the approval of the election of directors and officers; this reversal leads to affirmance on the cross-appeal.

We assume that, under the wide powers conferred by § 188 of the Bankruptcy Act, the District Court might permissibly conclude that an officer or employee of a debtor who had disentitled himself to receive compensation should no longer be allowed to serve even if his service was otherwise in the best interests of the estate. The question thus is whether appellants had done that.

Section 249 finds its source in two district court decisions, *In re Paramount-Publix Corp.*, 12 F. Supp. 823 (S. D. N. Y. 1935), and *In re Republic Gas Corp.*, 35 F. Supp. 300 (S. D. N. Y. 1936), denying compensation to members of committees who had traded in securities of a debtor in reorganization under § 77B of the Bankruptcy Act, 48 Stat. 912 (1934), the predecessor of Chapter X, see also *In re Mountain States Power Co.*, 118 F. 2d 405, 407 (3 Cir. 1941). Referring to these cases, the draftsmen of the Chandler Act explained that § 249 was "a development of the idea that fiduciaries who trade in the securities should be penalized; that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law" and constituted "a step toward the codification" of the rule laid down in the district court decisions, "an attempt to make it more uniform," and "broaden the base a little bit."[3] Decision whether the base was broadened so as to include an officer and a supervisory employee of a debtor in possession

[3] 75th Cong. 1st Sess., Hearings before the Committee on the Judiciary of the House of Representatives on H. R. 6439, pp. 183-184.

demands some examination of the latter concept and of the structure of the statute. Here, as in *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U. S. 216, 218 (1936), "there is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts."

The concept of leaving of a debtor in possession, "A receivership without a receiver," [4] was one of the many innovations introduced by § 77B to meet the insolvency problems of the great depression. The thought was that expense could be saved and perhaps efficiency gained by avoiding the universal appointment of trustees and continuing, in appropriate cases, the possession of corporate managements whose calamities, in many instances, had been due to national or even international economic forces quite beyond their control. After much debate, this practice was carried into Chapter X, in considerably reduced scope. The provisions dealing with it are found in Article VII—Proceedings Subsequent to Approval of Petition, §§ 156, 159, 162, 163, 168, and 170, and in Article VIII—Title, Rights, and Powers of Trustees and Debtors in Possession, especially §§ 188, 189, 190 and 191. The first sentence of § 191 provides "A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court." The orders with respect to Weinstein's employment were made pursuant to that section, and the orders with respect to Fried were evidently intended to be.

On the other hand, § 249 is contained in Article XIII, entitled "Compensation and Allowances." The initial sections, 241-246, describe the persons to whom reimbursement for costs and expenses and compensation for services rendered may be made. These include the referee, special

[4] Judge (then SEC Commissioner) Frank, 75th Cong. 2d Sess., Hearings before the Committee on the Judiciary of the Senate on H. R. 8046, p. 99, quoted in 6 Collier, Bankruptcy (14th ed. 1956), p. 1994, fn. 3.

masters, "the trustee and other officers" and their attorneys, the attorney for the debtor, the attorney for the petitioning creditors, indenture trustees, depositaries, reorganization managers, committees or representatives of creditors or stockholders, and certain other categories. Section 247 provides that "The judge shall fix a time of hearing for the consideration of applications for allowances," notice of which shall be given to a wide variety of parties in interest. After an intervening section not here relevant, comes § 249, quoted above.

If the words in the final sentence of § 249 "or other person acting in t' e proceedings in a representative or fiduciary capacity" were to be read in isolation and out of context, appellees would doubtless be right that Weinstein and Fried fell within them. However, as said in *United States* v. *American Trucking Ass'ns, Inc.*, 310 U. S. 534, 542 (1940), "To take a few words from their context and with them thus isolated to attempt to determine their meaning, certainly would not contribute greatly to the discovery of the purpose of the draftsmen of a statute." The last sentence of § 249 must be read not only with the preceding one but with the other sections of Article XIII. When the sentence is so read, it becomes fairly plain that the words "or other person acting in the proceedings in a representative or fiduciary capacity" relate only to persons so acting who fall within the categories allowed compensation under §§ 241, 242 or 243.

Officers of a debtor in possession are not among these. They are not "other officers" within § 241(3), at least if that term has the meaning specified in § 1(22), and we see no reason why it should not, since the defined meaning is not "inconsistent with the context." Nowhere do §§ 241, 242 and 243 refer to officers or employees of the debtor, an omission doubly significant in view of the specific mention of the attorney for the debtor in § 241(4). The reason for the

omission is plain enough. Such persons were not required to "seek compensation" through the necessarily cumbersome procedure of § 247, since compensation of officers of the debtor would have been approved under § 191 and employees would have been paid, under § 189, as if the debtor had remained solvent. Not being required to seek compensation under § 247, they have not been subjected to § 249, and the order of removal cannot survive the fall of its underpinning.[5]

Such a construction accords with the sense of the statute. The persons to whom Article XIII authorizes the allowance of compensation for services from the estate of the debtor are persons who would not have been rendering such services if the reorganization proceeding had not occurred. For these strangers the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from consensual arrangements, subject only, in the case of officers, to judicial approval under § 191. It would be altogether natural for Congress to prescribe that persons of the former sort, when acting in a representative or fiduciary capacity, should abstain from dealing in claims against or stock of the debtor on pain of forfeiting any right to compensation, without imposing a similar Draconian penalty upon the latter, who were being compensated during the Chapter X proceeding for the same executive services they had rendered before. At the very least, courts are justified in demanding a clear indication of Congressional purpose before inflicting what we have recognized as so harsh a forfeiture. *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F. 2d 862, 868 (2 Cir. 1959), cert. denied, 361 U. S. 862 (1959), upon persons who, despite their fiduciary obligations, had been free to buy or sell stock of the corporation before

[5] Reversal of the order of removal carries with it so much of the order as authorized Philip to supervise the debtor's affairs pending approval of a general manager to replace Fried

the Chapter X proceeding was contemplated, *SEC* v. *Chenery Corp.*, 318 U. S. 80, 88 (1943); *Manufacturers Trust Co.* v. *Becker*, 338 U. S. 304, 312-314 (1949), and would expect to remain with it thereafter.

If it be contended against this that the president and the general manager of a debtor in possession bear essentially the same relation to creditors and stockholders and have the same access to inside information as a trustee, and that since § 249 applies to the latter, it must therefore apply to the former, there are several answers—apart from the sufficient one that this is not what the words say. One is that in a closely related respect Chapter X clearly distinguishes between what is demanded of a trustee and what is expected of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional trustee whom the judge may appoint "to operate the business and manage the property of the debtor") must be "disinterested," which, under § 158(1), he is not if "he is a creditor or stockholder of the debtor." No such requirement was or practically could be imposed on officers of the debtor; instead, for that very reason, § 168 authorizes the judge to "appoint a disinterested person as examiner to prepare and file a plan" and to perform the investigative duties imposed upon the trustee by § 167(1) to (5). Also the argument under consideration proves too much. A salaried employee of the trustee entrusted with general supervision of the debtor's affairs, whether or not an officer of the debtor employed under § 191, would have the same access to inside information as the president or general manager of a debtor in possession; yet one would have to press hard, indeed, to read § 249 as including him.

Our ruling that § 249 is inapplicable to an officer or supervisory employee of a debtor in possession in no way entails as a consequence that a bankruptcy court is helpless to deal with breaches of fiduciary obligation on his

part. This Court has held, in the case of a person clearly within § 249, that failure to establish the purchase or sale that would trigger that section's denial of all compensation does not preclude or, indeed, relieve the court from taking account of related breaches of fiduciary obligation in fixing the amount, *Berner* v. *Equitable Office Building Corp.*, 175 F. 2d 218 (2 Cir. 1949). By the same token the court may consider, in an appropriate case, that a purchase or sale of stock by a person not within § 249 requires reduction or even elimination of compensation from an estate under the court's supervision, or removal of such person from office. See *American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U. S. 138, 146-147 (1940); see also *In re Midland United Company*, 159 F. 2d 340 (3 Cir. 1947). The distinction is that such a ruling would rest upon an exercise of judicial discretion, taking appropriate account of all relevant circumstances, rather than on the automatic forfeiture which the judge here thought the statute required. Nor is this all. Despite a statement to the House Judiciary Committee that § 249 was being presented in lieu of a proposal "that if a person in a fiduciary capacity uses inside information to purchase or sell securities, then he shall be penalized," [6] we cannot believe enactment of § 249 curtailed the inherent power of bankruptcy courts to impose remedies of a totally different sort for breach of fiduciary obligations, such as scaling down claims to the amounts paid or requiring an accounting for profits, even for persons subject to § 249 and surely for persons who are not; and again whether the final clause of § 212 is or is not literally applicable.[7] Decisions under § 77B providing

[6] *Supra* note 3.

[7] Section 212 permits the court, in the case of "an agent, attorney, indenture trustee, or committee," to "limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."

for such a scale-down as against directors of a debtor in reorganization, *In re McCrory Stores Corp.*, 12 F. Supp. 267, 269 (S. D. N. Y. 1935), and *In re Philadelphia & Western Ry.*, 64 F. Supp. 738 (E. D. Pa. 1946), were noted with apparent approval in *Manufacturers Trust Co.* v. *Becker*, *supra*, at 314 fn. (1949); see also *In re Norcor Mfg. Co.*, 109 F. 2d 407, 411 (7 Cir. 1940) and *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77 (S. D. Cal. 1941). Cf. *Mosser* v. *Darrow*, 341 U. S. 267 (1951). Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees complain; indeed, the judge's denial of "recoupment" would indicate he did not regard their conduct as having been very iniquitous.

Appellants attack also the portions of the order approving Philip's election as a director and as treasurer and requiring his countersignature of checks; they assert that Philip's true allegiance is to Rehrig, who, they claim, is seeking to make a lease unfavorable to the debtor's interests.

The volume and character of the papers in this proceeding leave little doubt that directors' meetings attended by Weinstein and Philip are scarcely likely to set new records in pastoral harmony. However, Pennsylvania, where the debtor is incorporated, considers a minority's right to representation on a corporate board of directors so vital that it has enshrined cumulative voting in its Constitution, Art. XVI, § 3—although both proponents and opponents of that system recognize that the presence of sharply conflicting interests among the directors may result. See Williams, Cumulative Voting for Directors (1951), c. X; Baker and Cary, Cases and Materials on Corporations (3d ed, unabridged 1959), pp. 209-210; Young, The Case for Cumulative Voting, 1950 Wis. L. Rev. 49, 53; Axley, The Case Against Cumulative Voting, 1950 Wis. L. Rev. 278, 279. Consistent and vigor-

ous advocacy of policies honestly deemed by the majority to be seriously adverse to corporate interests would thus not be a ground for disqualifying a minority director in Pennsylvania, although a record of actual obstruction would be, *Markovitz v. Markovitz*, 336 Pa. 145, 8 A. 2d 46 (1939). To be sure, a court of bankruptcy is not bound to approve a director simply because he has been elected to represent a minority through cumulative voting, any more than it would be to approve one elected by a majority with or without such procedures. Still some weight ought to be given to Pennsylvania's policy and, even apart from that, the stockholders' election of directors "will not be disturbed unless a clear case of abuse is made out" or it appears that judicial veto is required "to the end that the property may be safely and effectively managed." *In re J. P. Linahan, Inc.*, 111 F. 2d 590, 592 (2 Cir. 1940). As one of three directors Philip will have no power to force the making of a lease to Rehrig, and this presumably would require the court's approval in any event. There is nothing as yet to show that as a director, or as treasurer, Philip will obstruct the operation of the business in the private interest of the Rehrig group as distinguished from acting as its voice and ears; we read § 188 as empowering the court to remove him if he should. On the other hand, the requirement of Philip's countersignature of all checks might well jeopardize the successful functioning of the business; indeed, it is not at all clear that the judge meant this to continue beyond the appointment of a new general manager in place of Fried.

The order is therefore reversed save for its approval of the election of directors and officers, as to which it is affirmed.[8]

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[8] Nothing herein is to be deemed to preclude the judge from taking any further action with respect to directors or officers that he may find appropriate as a result of our decision in Docket Nos. 27000 and 26962.

Appendix C

Text of Statutes Cited

Bankruptcy Act, §§ 1(22), 1(23): 11 U.S.C. §§ 1(22), 1(23); 52 Stat. 840 (1938):

§ 1. *Meaning of Words and Phrases*

The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: * * * .

(22) "Officer" shall include clerk, marshal, receiver, custodian, referee, and trustee, and the imposing of a duty upon, or the forbidding of an act by, any officer shall include his successor and any person authorized by law to perform the duties of such officer;

(23) "Persons" shall include corporations, except where otherwise specified, and officers, partnerships, and women, and when used with reference to the commission of acts which are forbidden under this Act shall include persons who are participants in the forbidden acts, and the agents, officers, and members of the board of directors or trustees or of other similar controlling bodies of corporations; * * *.

Bankruptcy Act, § 115; 11 U.S.C. § 515; 52 Stat. 884 (1938):

§ 115. *Same; Jurisdiction as in Insolvency*

Upon the approval of a petition, the court shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.

Appendix C

Bankruptcy Act, § 116(1); 11 U.S.C. § 516(1); 52 Stat. 885 (1938):

§ 116. *Same; Additional Jurisdiction over Administration of Estate*

Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court—

(1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice to the parties to such contracts and to such other parties in interest as the judge may designate; * * *.

Bankruptcy Act, § 156; 11 U.S.C. § 556; 52 Stat. 888 (1938):

§ 156. *Appointment of Trustees; Continuance of Debtor in Possession*

Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.

Appendix C

Bankruptcy Act, § 157; 11 U.S.C. § 557; 52 Stat. 888 (1938):

§ 157. *Attorney for Trustee*

An attorney appointed to represent a trustee under this chapter shall also be a disinterested person: *Provided, however,* That for any specified purposes other than to represent a trustee in conducting the proceeding under this chapter the trustee may, with the approval of the judge, employ an attorney who is not disinterested.

Bankruptcy Act, § 158; 11 U.S.C. § 558; 52 Stat. 888 (1938):

§ 158. *Interest of Persons*

A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this Act, if—

(1) he is a creditor or stockholder of the debtor; or

(2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

(4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

Appendix C

Bankruptcy Act, § 168; 11 U.S.C. §568; 52 Stat. 890 (1938):

§ 168. *Same; Disinterested Person Where Debtor is in Possession*

If a debtor is continued in possession, the judge may at any time appoint a disinterested person as examiner to prepare and file a plan and to perform the duties imposed upon a trustee under paragraphs (1) to (5), inclusive, of section 167 of this Act, or to perform any of such duties.

Bankruptcy Act, § 188; 11 U.S.C. § 588; 52 Stat. 892 (1938):

§ 188 *Debtor in possession; title, rights, duties, and powers*

A debtor continued in possession of its property shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe.

Bankruptcy Act, § 191; 11 U.S.C. § 591; 52 Stat. 893 (1938):

§ 191. *Employment of Officers of Debtor*

A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court.

Bankruptcy Act, § 196; 11 U.S.C. § 596; 52 Stat. 893 (1938):

§ 196. *Filing and Allowing Proofs of Claims; Objections to Allowances*

After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the

proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the Court.

Bankruptcy Act, § 212; 11 U.S.C. § 612; 52 Stat. 895 (1938):

§ 212. *Same; Regulation by Court*

The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation of in the course of the proceeding under this chapter to the actual consideration paid therefor.

Bankruptcy Act, § 221(4); 11 U.S.C. § 621(4); 52 Stat. 897 (1938):

§ 221. *Confirmation by Court*

The judge shall confirm a plan if satisfied that— * * *

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; * * *.

Appendix C

Bankruptcy Act, § 247; 11 U.S.C. § 647; 52 Stat. 901 (1938):

§ 247. *Hearing of applications*

The judge shall fix a time of hearing for the consideration of applications for allowances, of which hearing notice shall be given to the applicants, the trustee, the debtor, the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate, except that, in the case of allowances for services and reimbursement in a superseded bankruptcy proceeding, notice need be given only to the applicants, the debtor, the trustee, and the unsecured creditors, and may be given to such other classes of creditors or other persons as the judge may designate. In the case of the dismissal of a proceeding under this chapter and the entry of an order therein directing that bankruptcy be proceeded with, notice of the hearing to consider allowances need not be given to stockholders.

Bankruptcy Act, § 249; 11 U.S.C. § 649; 52 Stat. 901 (1938):

§ 249. *Statement of Claims or Stock Acquired or Transferred after Commencement of Proceeding*

Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

Appendix C

Amendatory Act, § 5b; Additional Provisions of the Act of June 22, 1938 (The Chandler Act, ch. 575, 52 Stat. 840), § 5b; 11 U.S.C. § 1, notes:

§ 5. *Severability; Headings.*

* * *

b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate.

Bankruptcy Act, § 77B(c); 11 U.S.C. § 207(c); 48 Stat. 915 (1934) [*Repealed*]:

§ 77B(c) [*Repealed*] Upon approving the petition or answer or at any time thereafter, the judge, in addition to the jurisdiction and powers elsewhere in this section conferred upon him, * * *

(9) may allow a reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses incurred in connection with the proceeding and the plan by officers, parties in interest, depositaries, reorganization managers and committees or other representatives of creditors or stockholders, and the attorneys or agents of any of the foregoing and of the debtor, but appeals from orders fixing such allowances may be taken to the Circuit Court of Appeals independently of other appeals in the proceeding and shall be heard summarily; * * *

While the debtor is in possession (a) its officers shall be entitled to receive only such reasonable compensation as the judge shall from time to time approve, and (b) no person shall be elected or appointed to any office, to fill a vacancy or otherwise, without the prior approval of the judge.

Appendix C

Bankruptcy Act, § 77B(f)(5); 11 U.S.C. § 207(f)(5); 48 Stat. 919 (1934) [*Repealed*]:

§ 77B(f) [*Repealed*] After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that * * *

(5) all amounts to be paid by the debtor or by any corporation or corporations acquiring the debtor's assets, and all amounts to be paid to committees or reorganization managers, whether or not by the debtor or any such corporation for services or expenses incident to the reorganization, have been fully disclosed and are reasonable, or are to be subject to the approval of the judge; * * *.

28 U.S.C. § 1652; 62 Stat. 944 (1948):

§ 1652. *State laws as rules of decision*

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

Rule 52(a), Fed. Rules of Civ. Proc., *f.* 28 U.S.C. § 2072:

Rule 52. *Findings by the Court*

(a) EFFECT. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes

of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

Pa. Constitution, Art. XVI, § 7 (1874, 1956):

§ 7. *Stocks and bonds; increase of indebtedness*

No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock and indebtedness of corporations shall not be increased except in pursuance of general law, *nor without the consent of the persons holding the larger amount in value of the stock, first obtained at a meeting to be held after sixty days notice in pursuance of law.* [*Italicized words deleted by 1956 amendment.*]

Pa. Bus. Corp. L. § 604; 15 Purdon's Pa. Stats. Ann. § 2852-604; P.L. 364, Art. VI, § 604 (1933):

§ 604. *Payment of Subscriptions for Shares*

Unless otherwise provided in the subscription agreement, subscriptions for shares, whether made before or after the organization of a corporation, shall be paid in full at such time, or in such installments and at such times, as shall be determined by the board of directors. Any call made by the board of directors for payment of subscriptions shall be uniform as to all shares of the same class, or as to all shares of

the same series, as the case may be. The director shall cause notice of the amount of any call, and of the time and place of payment, to be given at least thirty days before the date the call is due, either personally or by mail addressed to each shareholder at his last address, as it appears on the books of the corporation. If a shareholder be indebted to a business corporation on account of unpaid subscriptions for shares, the corporation shall have a lien upon such shares for such indebtedness. Shares for which the agreed consideration has been paid, delivered, or rendered to the corporation shall be fully paid shares and non-assessable. No note or obligation given by a shareholder, whether secured by pledge or otherwise, shall be considered as payment, in whole or in part, of any shares of a business corporation.

Pa. Bus. Corp. L. § 605; 15 Purdon's Pa. Stats. Ann. § 2852-605; P.L. 364, Art. VI, § 605 (1933):

§ 605. ***Defaults in Payment of Consideration for Shares***

When any shareholder fails to pay any call upon his shares properly made by the directors, at the time when such payment is due, the directors may proceed to collect the amount due in the same manner as any debt due the corporation, or they may sell, at public sale, such part of the shares of the delinquent shareholder as will pay all or any part of the installments then due from him, with interest and all incidental expenses, and transfer the shares so sold to the purchaser, who shall be entitled to a certificate therefor. Notice of the time and place of such sale, and of the sum due on each share, shall be given by advertisement, once a week for two consecutive weeks next preceding the date fixed for the sale, in a newspaper of general circulation published in the county where the corporation has its registered office and in the legal newspaper, if any, designated by the rules of court for the publication of legal

notices in such county, or, if there be no newspaper of general circulation published in such county, then in a newspaper of general circulation in such county, and such notice shall be mailed by the treasurer of the corporation to the delinquent shareholder, at his last known post office address, at least twenty days before the date fixed for such sale. If no bidder can be had to pay the amount due on the shares, or if the amount is not collected by an action at law brought within the county where such corporation has its registered office, the shares shall be forfeited to the corporation, and the amount previously paid in by the delinquent shareholder on the shares shall be forfeited to the corporation. Such shares, if forfeited, may be reissued or reoffered for subscription by the corporation. No share shall be voted at any meeting upon which any installment is due and unpaid.

Pa. Bus. Corp. L. § 609; 15 Purdon's Pa. Stats. Ann. § 2852-609; P.L. 364, Art. VI, § 609 (1933):

§ 609. *Liability of Subscribers and Shareholders*

A subscriber to, or holder of, shares of a corporation formed under this act shall not be under any liability to the corporation with respect to such shares, other than the obligation of complying with the terms of the subscription for such shares. Any person becoming an assignee or transferee of shares, or of a subscription for shares, in good faith and without knowledge or notice that the full consideration therefor has not been paid, shall not be personally liable to the corporation or its creditors for any unpaid portion of such consideration. No person holding shares as executor, administrator, guardian, trustee, receiver, or in any other representative or fiduciary capacity, shall be personally liable as a shareholder by reason of so holding such shares, but the estate and funds in the hands of such fiduciary or representative shall be so liable. No pledgee or

other holder of shares as collateral security shall be personally liable as a shareholder, but the person pledging such shares shall be considered the holder thereof and shall be liable as a shareholder.

Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P.L. 364, Art. VI, § 610 (1933):

§ 610. *Validity of Shares*

The fact that shares are issued in violation of, or without full compliance with, the provisions of this act shall not make the shares so issued invalid, unless they are issued in violation of Article XVI, Section seven, of the Constitution of this Commonwealth.

15 Purdon's Pa. Stats. Ann. § 315; P.L. 126, § 15 (1911) [*Repealed*]:

§ 315. *Lien of corporation and restrictions on transfer*

There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation, and there shall be no restriction upon the transfer of shares so represented, by virtue of any by-law of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate.

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-103; P.L. 3, § 8-103 (1953):

§ 8-103. *Issuer's Lien*

A lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such lien is set forth conspicuously on the security.

Appendix C

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-204; P.L. 3, § 8-204 (1953):

§ 8-204. *Effect of Issuer's Restrictions on Transfer*

A restriction on transfer imposed by the issuer even though otherwise lawful is ineffective unless noted conspicuously on the security.

21 Purdon's Pa. Stats. Ann. § 601, P.L. 425, § 1(1901):

§ 601. [*RESULTING TRUSTS*] *Validity*

Whenever hereafter a resulting trust shall arise with respect to real property, by reason of the payment of the purchase money by one person, and the taking or making of a legal title in the name of another, if the person advancing the purchase money has the capacity to contract, such resulting trusts shall be void and of none effect as to bona fide judgment or other creditors, or mortgagees of the holder of the legal title, or purchasers from such holder without notice unless either (1) a declaration of trust in writing has been executed and acknowledged by the holder of the legal title, and recorded in the recorder's office of the county where the land is situated, or (2) unless an action of ejectment has been begun, in the proper county, by the person advancing the money, against the holder of the legal title.

N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) § 91:

§ 91. *Certain uses and trusts abolished*

Uses and trusts concerning real property, except as authorized and modified by this article, have been abolished; every estate or interest in real property is deemed a legal right, cognizable as such in the courts, except as otherwise prescribed in this chapter.

Appendix C

N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) § 94:

§ 94. *Grant to one where consideration paid by another*

A grant of real property for a valuable consideration, to one person, the consideration being paid by another, is presumed fraudulent as against the creditors, at that time, of the person paying the consideration, and, unless a fraudulent intent is disproved, a trust results in favor of such creditors, to an extent necessary to satisfy their just demands; but the title vests in the grantee, and no use or trust results from the payment to the person paying the consideration, or in his favor, unless the grantee either,

1. Takes the same as an absolute conveyance, in his own name, without the consent or knowledge of the person paying the consideration; or,

2. In violation of some trust, purchases the property so conveyed with money or property belonging to another.

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Supreme Court of the United States

October Term, 1961

No. 770

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZNELL,

Petitioners,

AGAINST

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS and FARMERS' MARKET INC., et al.,

Respondents.

IN THE MATTER

OF

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.,

Debtor.

Brief for Respondent Nazareth Fair Grounds & Farmers Market, Inc., Debtor and Debtor in Possession in Opposition to Petition for Certiorari

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Supreme Court of the United States

OCTOBER TERM 1961

No. 739

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZNELL,

Petitioners,

AGAINST

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS and FARMERS' MARKET INC., et al.,

Respondents.

In the Matter

of

NAZARETH FAIR GROUNDS & FARMERS MARKET, INC.,

Debtor.

Brief for Respondent Nazareth Fair Grounds & Farmers Market, Inc., Debtor and Debtor in Possession in Opposition to Petition for Certiorari

Statement

Petitioners pray that Writs of Certiorari issue to review the two judgments of the Court of Appeals for the Second Circuit, to wit, in:

1. Case No. 27,000—Where the Court of Appeals by judgment made and entered on November 9, 1961 resolved the allowance, disallowance or modification of stock claimants by affirming in part, modifying or reversing in part the order of the District Court of the Southern District of New York;

2. Case No. 26,362—Where the Court of Appeals by judgment made and entered on November 9, 1961 reversed that part of the order of the District Court of the Southern District of New York which prohibited Weinstein, the President of the Debtor and Debtor in Possession from having anything to do with the operations of the debtor's business and which discharged Fried, the manager of the Debtor and Debtor in Possession from his employment, and affirmed that part of the order which failed to direct Weinstein and Fried to reimburse the Debtor for the compensation and expenses heretofore paid and received by them.

The Facts in Case No. 27,000

The facts in this case are more than adequately set forth in Judge Moore's opinion, which appears in Appendix A, pages 33a to 47a inclusive of the Petition for Writs of Certiorari, and to which the writer respectfully refers this Court.

The Facts Condensed in Case No. 26,362

The facts elicited on the trial but not fully reported in the Court of Appeals' decision are respectfully submitted.

After the reorganization, the District Court signed an order authorizing the Debtor to operate the business of

the Debtor in Possession. Arnold Weinstein, who had been elected President, and Jerome Fried, who had been designated as General Manager, were authorized by the District Court to perform their duties on behalf of the Debtor in Possession. They were in fact employees of the Debtor and Debtor-in Possession and their weekly salary was fixed by order of the Court, under Chapter X, Article 8, Section 191.

From 1951 to August 1953 the Debtor was bankrupt factually, and technically as defined in the Bankruptcy Act. The Debtor's business operated at a loss prior to the inception of this proceeding.

Weinstein's and Fried's management was so successful that an operating loss was turned into a profit and by 1960, the Debtor was able to realize a profit of approximately $45,000.

In 1955, Melvin Lloyd Robbins, Esq. first appeared in this proceeding. He claimed that he represented a Wilson Rehrig and a Martin Philip, Esq., Mr. Rehrig's attorney. Mr. Rehrig was a tenant of the Debtor in Possession whose lease expired. He wanted a new lease at about the same rental as he had been paying before. He wanted the Debtor in Possession to make certain improvements to that portion of the premises leased to him. Since the cost of operations and maintenance had increased, the Debtor in Possession required and was getting increased rentals from almost all of its other tenants. Rehrig refused to pay an increase, or even pay the increased rental which had been offered by a prospective tenant who was interested in the same space. Rehrig further demanded a monopoly or exclusive tenancy in the meat and provision business, so that no other merchant could sell meat and provisions on the Debtor's premises.

As a result of the foregoing, negotiations were stalemated. Suddenly, Robbins started to raid the Debtor by purchasing the stock of certain stock claimants in an endeavor to obtain control of the Debtor. Rehrig, has admitted in open Court when he was on the witness stand that he had a conflict of interest with the Debtor, and that if he got control of the Debtor he would attempt to give himself an exclusive lease at a beneficial rental.

Thereafter, certain stock claimants told Weinstein and Fried that they had been approached by Robbins and asked whether they would sell their stock to him. Weinstein and Fried advised them not to sell their stock, that Debtor's prospects were good. The foregoing was substantiated by the testimony of these stock claimants in Court. They testified that they intended to sell their stock to either Robbins, or Weinstein and Fried and, that under those circumstances, they had sold their stock to Weinstein and Fried.

Weinstein and Fried testified that they bought stock in an endeavor to comply with the trust imposed upon them in order to prevent control of this corporation from falling into the hands of a "raider" whose interests conflicted with the Debtor's.

The District Court by its decision held that assuming the truth of the foregoing, he was still technically bound by Section 249, to remove Fried and Weinstein so that they could not participate in the Debtor's operations.

In question 1 presented on page 3 of petitioners' brief, Mr. Robbins has attempted to smear Weinstein and Fried by alleging that they diverted the Debtor's rents to themselves. This charge is totally false, unsubstantiated by the proof in this case. It has no place in the issues submitted on this petition for Certiorari.

The Issues in Case No. 27,000

I. In determining which claimants shall share in the liquidation of the bankrupt's estate as general creditors or as stock claimants, is a Bankruptcy Court required to follow State law, or can it apply its own equitable principles?

II. Does petitioners' application pose a constitutional question or a question undecided and of such major importance as would warrant the granting of a Writ of Certiorari?

The Issues in Case No. 26,362

I. Does Section 249 of the Bankruptcy Act apply to an officer or general manager of a Debtor in Possession who are receiving compensation pursuant to Sections 189 and 191?

II. In the event Section 249 does apply, should an officer and general manager who salvaged and successfully operated a bankrupt debtor be penalized and removed from employment and have the compensation heretofore paid to them confiscated because they purchased stock solely to stop a raider, who had a conflict of interest with the Debtor from obtaining control of the Debtor?

The Law on Case No. 27,000

POINT I

A Bankruptcy Court is not required to apply State Statutes in allowing or disallowing claims.

Jurisdiction to allow or disallow claims is based on Section 2A (2) of the Bankruptcy Act which is made applicable to Chapter X proceedings by virtue of Section 102

of the Bankruptcy Act. This Court has consistently followed the principle that a Court of Bankruptcy speaks as a Court of Equity and allows or disallows claims by applying its own equitable theories and its own substantive law of bankruptcy and is not bound by State Statutes or theories. The petitioner has stressed *Erie R. Co.* v. *Tompkins* to support his contention that a Court of Bankruptcy must follow state law.

This Court in the case of *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, 62 Sup. Ct. 978, stated however:

> "Nothing decided in Erie R. Co. v. Tompkins 304 U. S. 54, 58 Sup. Ct. 817 requires a Court of Bankruptcy to apply such local rules governing the liquidation of insolvent estates.
>
> "The Bankruptcy Act prescribes its own criteria for a distribution to creditors.
>
> "In the interpretation and application of federal statutes, federal, not local law applies."

This Court in the case of *Holmberg* v. *Ambrecht*, 327 U. S. 392, 66 Sup. Ct. 582, stated:

> "The considerations that urge adjudication by the same law in all courts within a state when enforcing a right created by that state are hardly relevant for determining the rules which bar enforcement of an equitable right created not by a state legislature but by congress.
>
> "The present case concerns not only a federally created right but a federal right for which the sole remedy is in equity * * * we do not have the duty of a federal court sitting as it were as a court of a state to approximate, as closely as may be state law, in order to vindicate without discrimination a right derived solely from a state. We

> have the duty of federal courts sitting as national courts throughout the country to apply their own principle in enforcing an equitable statute created by congress."

This Court further held in *Pepper* v. *Litton*, 308 U. S. 295, 60 Sup. Ct. 238:

> "In passing upon the allowance of claims, a bankruptcy court sits as a court of equity clothed with jurisdiction to sift the circumstances in the administration of the bankrupt estate."

In *Kelley, Glover & Vale, Inc.* v. *Kramer*, 344 U. S. 914, 73 Sup. Ct. 337, this Court denied Certiorari from a Court of Appeals decision, 198 F. 2nd 392, where the same issue was involved. The Court held that where the allowance or disallowance of claims is an issue, a bankruptcy court is not required to follow state statutes.

This Court held in *Vanston* v. *Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 162, 67 Sup. Ct. 237, 240, that the bankruptcy court must enforce the Bankruptcy Act as interpreted by this Court with authority granted by Congress to determine how and what claims would be allowed under equitable principles. These general principles are again enunciated by this Court in *American Surety Company* v. *Sampsell*, 327 U. S. 269, 66 Sup. Ct. 571.

In any event, petitioner's theory of the law, that Pennsylvania Law as set forth in its statutes and Court decisions forbid the cancellation of stock issued to stock claimants who paid no consideration to the Debtor, and relegates the corporation to having a lien on the stock, followed by foreclosure is not in conformity with the decisions of the Courts of Pennsylvania or of this Court.

Cf. National Bank of Shamokin v. *Waynesboro Knitting Co.*, 314 Pa. 365, 172 A. 131, 133. *Appeal of Kisterbock*, 127 Pa. 601, 18 A. 381. *Moores* v. *Citizens' National Bank of Piqua* (1884), 111 U. S. 156.

It is important to note that the Supreme Court held in *McCandless* v. *Furland*, 296 U. S. 80, 121, 56 S. Ct. 41, 140 L. Ed. 158, that the act of promoters also violated Acts 16 and 17 of the Pennsylvania Constitution forbidding corporations to issue stock or bonds, except for money, labor or property actually received and declaring all fictitious increases void. This prohibition may not be set aside by shareholders to the prejudice of creditors or other shareholders, present or prospective.

This Court in a similar case involving promotions and syndication of a corporation formed in the State of Pennsylvania held in the case of *Davis* v. *Las Ovas Co.*, 227 U. S. 80, 30 Sup. Ct. 197:

> "Where the fraud on a corporation resulted in the issuing of more stock than would otherwise be necessary, the proper decree is to compel those who fraudulently obtained the additional stock, to surrender it for cancellation and such stock should be cancelled;"

Constructive trusts or the imposition of trusts have been sustained by the highest courts in Pennsylvania. (*Cf. Zohrosky* v. *Leschinskey*, 394 Pa. 368, 147 A. D. 2d 362.)

The Law on Case No. 26,362

POINT II

The restrictions and penalties imposed under Chapter X, Article 13, Section 249 should not be applied to an officer or employee hired by a debtor in possession under Chapter X, Article 8, Section 19.

Respondents cannot improve on the determination of the law on the issues involved as stated by the Court of Appeals and respectfully refers this Court to the decision thereto.

However, eliminating the technicalities and going to the merits, it is unbelievable that Congress or the courts intended that any statute should be interpreted and utilized so as to destroy the very purpose of its creation, and thus aid the evil doer and condemn the innocent; so as to compel a trustee or fiduciary to violate his trust.

True, Section 249 was specifically enacted so that trustees and fiduciaries or their agents should not trade in a reorganized company's stock for their own pecuniary benefit or for profit. However, the primary purpose of this and other like sections of the bankruptcy act were enacted to protect the debtor, its creditors and stockholders.

When the petitioners, whose interests were in direct conflict with the debtor, raided and attempted to get control of the debtor, it was the primary duty of Weinstein and Fried, in the interests of the debtor, to stop that plan from being effectuated.

Weinstein and Fried, under those circumstances had to buy stock.

Their own pecuniary benefit was not served.

They did not know whether the stock they purchased had any validity. As a matter of fact, a substantial portion of the stock so purchased by them was strenuously opposed on the trial of the claims and on appeal by the attorney for the Debtor and was disallowed.

There is no basis technically factually, morally or otherwise for a Writ of Certiorari to be granted as petitioned for.

Commentary

The record does not sustain petitioner's statements of the facts and I feel impelled to observe that in it there are numerous errors of fact as well as facts which are wholly outside the record.

CONCLUSION

The petition for writs of certiorari should be denied.

Dated: New York, New York
March 1962.

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MARVIN N. ROSEN,
On Brief.

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Supreme Court of the United States

OCTOBER TERM, 1961

No. [illegible]

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,
Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,
Respondents.

IN THE MATTER
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,
Debtor.

BRIEF IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

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Supreme Court of the United States

OCTOBER TERM, 1961

No. 739.

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

IN THE MATTER

of

NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

BRIEF IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

Questions Presented.

No. 26362

Does §249 of the Bankruptcy Act, which denies compensation to applicants for an allowance who have traded in the shares of a Chapter X Debtor, apply to an officer and employee who were not applicants for an allowance but who had been continued in the employ of the Debtor-in-Possession by orders of the Bankruptcy Court under §§189 and 191 on a weekly salary basis?

The Court of Appeals held §249 inapplicable.

No. 27000

Where a promoter, without assets of his own, had collected funds for investment in a fair grounds and market enterprise, and none of the money had actually reached the corporation that was to operate it, but the promoter had used a portion thereof for the acquisition of the property by the corporation, and had distributed stock certificates on an original issue basis to the investors and to others, did the Court of Appeals in a Chapter X Proceeding correctly hold that the stock claimants who entrusted their money to the promoter for investment in the market property should be recognized as stockholders in the proportion of their respective contributions, and that those who received certificates in payment of, or as security for the promoter's own debts arising from unrelated transactions should not be recognized as stockholders?

PROPOSED SEVERANCE FROM MANAGEMENT AND DENIAL OF SALARY TO OFFICER AND SUPERVISORY EMPLOYEE.

[No. 26362]

Statement.

The facts are stated in the opinion of the Court below by Friendly, J. [Appendix B, 49a-51a].

In sum, Weinstein had been president and Fried manager of the Debtor prior to the filing of the Chapter X petition. After approval of the petition, Weinstein was continued at $50 a week by an order granted under §191 of the Bankruptcy Act. Fried was also employed by the Court's authority under the mistaken impression that he was an officer, "secretary-treasurer". Concededly, he was not. Successive orders increased his salary to $200 a week. On June 14, 1960, the District Court severed Weinstein and Fried from the Debtor's employ and denied them any further compensation for the reason that each of them had purchased and sold a few shares of the Debtor's stock during the Chapter X Proceeding.

The controversy whether there was due from the race track corporation controlled by Fried more rent than had actually been paid the Debtor has no place in this case. As the Court of Appeals noted [Appendix B, 51a], the District Court separated Weinstein and Fried from the management of the Debtor "solely because they, as fiduciaries, violated section 249 of the Bankruptcy Act by dealing in the Debtor's stock." No other question was passed on by the District Court, and the review of the Court of Appeals was necessarily limited to that question.

Reasons for Denying Certiorari.

The Court of Appeals properly held that §249 of the Bankruptcy Act did not apply to salaried personnel such as Weinstein and Fried.

Article VIII of Chapter X of the Bankruptcy Act deals with the titles, rights and powers of trustees and debtors in possession. It was under §191 of this article that Weinstein and Fried were continued in employ at a salary. Article XIII deals with compensation and allowances, and it is in this article that §249, relating to stock-trading, is found. The Court of Appeals held that that section relates only to applications for allowances covered by the prior sections of Article XIII, that it does not apply to persons employed on a salary basis under a section found in Article VIII.

Petitioners argue from a plane of high principle, as if §249 were but a codification of a general proposition of law. There is no such general proposition. *Securities Commission* v. *Chenery Corporation* (1943) 318 U. S. 80, was a reorganization under the Public Utility Holding Company Act. In that case this Court reversed the action of the Securities and Exchange Commission in denying to officers and directors, who had bought and sold the corporation's stock during the reorganization, the benefit of their trades. This Court said, per Frankfurter, J. (p. 88):

> "As the Commission concedes here, the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock."

And again (pp. 92-3):

> "But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards —either the courts or Congress or an agency to which Congress has delegated its authority. Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions."

The question thus simmers down to one of statutory construction. Did Congress intend to include in §249 officers or employees, such as these, or did it not? The application of the ordinary canons of construction indicates that Congress did not so intend.

A. Weinstein and Fried were not "fiduciaries" of the Debtor within the meaning of §249.

The strictures of §249 fall on "* * * any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, * * *". This is a perfect situation for the application of *noscitur a sociis*. Petitioners recognize this, since they are careful to exclude from their quotation of the section all descriptive words except "person acting in the proceedings in a representative or fiduciary capacity, * * *". [Petition, p. 10.] The maxim is the more applicable since "fiduciary" is a word which may easily take its color from its associates. As was said by Frankfurter, J. in *SEC.* v. *Chenery Corp.* (1943) 318 U. S. 80, 85-6:

> "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To

> whom is he a fiduciary? What obligation does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

The "fiduciary" mentioned in the statute is manifestly of the type that goes with the other appellations used.

It is not disputed that there is no reported case in which the Court has ever applied §249 so as to disallow compensation to any persons other than committee members or lawyers.

B. The Petitioners' argument fails to distinguish between the function of reorganization and the function of carrying on the business of the Debtor.

The person who is to be denied compensation under §249 is a "person acting in the proceedings". This clearly relates to the legal steps leading to a plan of reorganization and not to services performed in a purely ministerial capacity.

With respect to §243, also found in Article XIII, it was said, per Hamilton, C. J. in *Gochenour* v. *Cleveland Terminals Bldg. Co.* (6 C. A. 1944), 142 F. 2d 991, 995:

> "This section of the Act relates entirely to matters in connection with the reorganization of the debtor and proceedings on behalf of creditors and stockholders. It comprehends matters directly affecting the plan of reorganization and excludes those indirectly affecting it."

This proposition is fortified by the fact that Article XIII, in which §249 is found, follows Articles X, XI and XII, which deal solely with the plan of reorganization and with the necessary proceedings if the plan fails.

C. The Bankruptcy Act draws a line between those who are hired and those who seek an allowance.

Weinstein and Fried stand in an entirely different position toward the Debtor from the persons designated in §249. In one case, the relationship is contractual; in the other, there is no contract and compensation depends on benefit to the estate as determined in the Court's discretion.

Weinstein and Fried were performing the same services before the petition for reorganization was filed as they were after. They were hired at fixed salaries and simple contract law would require payment.

Applicants for an allowance stand on an entirely different footing. They have no contractual claim against the Debtor. They stand before the Court seeking its grace, and the Court, subject to appellate review, may in its discretion grant or refuse an allowance. If there has been trading in securities, the Court must disallow it under §249. Apart from §249, the sole test is whether they benefited the estate. In *Dickinson Co.* v. *Cowan* (1940) 309 U. S. 382, the Court said, per Douglas, J. (p. 389):

> "Fee claimants are either officers of the court or fiduciaries, such as members of committees, whose claims for allowance from the estate are based only on service rendered to and benefits received by the estate. Allowance or disallowance involves an exercise of sound discretion by the court based on that statutory standard."

Petitioners picture Weinstein and Fried as applicants for allowances who are privileged to receive their compensation weekly instead of having to wait until the conclusion of the case. This wholly ignores the distinction between those working on contract, on the one hand, and those applying for an allowance, on the other. It would be a quaint

conception that all employees of a debtor-in-possession are merely applicants for allowance subject to §249 and that the weekly stipends that they receive are to be regarded merely as advances.

D. The procedural machinery provided for the enforcement of §249 is wholly inappropriate to a hired employee or to an officer employed on a weekly basis under §191.

§249 requires the applicant for allowance for services or disbursements to "file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding." Congress surely did not intend that officers of the debtor continued under §191, or employees generally, would file such a verified statement *in court* each week before receiving their pay checks. Some simpler and more practical machinery would most certainly have been devised. Compliance with the section would obviously render it impractical for a debtor-in-possession to employ and keep a staff, or, in fact, to carry on business at all.

E. The harshness of the remedy, which denies all compensation, argues against stretching §249 beyond its setting in Article XIII.

§249, obviously, is a section which easily lends itself to violation by persons in complete ignorance of its existence. Where §249 has been applied within its proper compass the Courts have done so regretfully and almost with apology.*

Judge Dimock *In re Third Avenue Transit Corporation* (S. D. N. Y. 1958), 159 F. Supp. 440, 443, aff'd (1959) 266

* In *Finn v. Childs Co.* (2 C. A. 1950), 181 F. 2d 431, where compensation of committeemen was denied under §249, the Court said, per Clark, Ch. J. (p. 441): "Of course this does not mean that their activity was improper."

F. 2d 862, cert. den. (1959), 361 U. S. 862, said of the application of §249 in that case "This result is nothing short of tragic." "Regret" was the word used by the District Court in rendering its judgment here [F8a].

The Court of Appeals below called the remedy "Draconian" [Appendix B, 55a]. While §249 no doubt serves a useful purpose in the cases for which Congress intended it, there seems little reason why the tragedy should be spread by a forced application.

§249 should not be dragged from its logical relationship to applications for allowance under Article XIII and applied with all its severities to salaries paid for ministerial services provided for under a wholly different article of the Bankruptcy Act.

DETERMINATION OF STOCK INTERESTS IN THE DEBTOR CORPORATION.

[No. 27000]

Statement.

The facts are stated in the opinion of the Court below by Moore, J. [Appendix A to Petition, 33a-47a]. They may be summarized as follows:

The Debtor, a Pennsylvania corporation, was organized August 7, 1951. On September 26, 1951, it acquired title, subject to mortgages, to the fair grounds and farmer's market at Nazareth, Pennsylvania.

The Debtor was authorized to issue two hundred shares of stock. After the filing of the Chapter X Petition on September 28, 1953, the Court ascertained that certificates for 316 shares had found their way into the hands of various persons, none of whom had dealt directly with the corporation.

In accordance with §196 of the Bankruptcy Act (11 U. S. C. A. §596), the District Court directed all claimants to stock interests in the Debtor to file their claims. Pursuant thereto forty-one persons presented their claims to the Bankruptcy Court. After objections had been interposed, extensive hearings were had from which the following facts appeared:

Between March 14, 1951 and March 25, 1953, one Malakoff, who had no assets of his own, received from persons whom he solicited to invest in the market property an aggregate of $145,075. These investors paid their money to Malakoff. None was paid directly to the corporation.

Between June 26, 1951 and February 15, 1952, he paid for the acquisition of the market property, in installments, a total of $58,996. Only about $40,000 of the investors' money is directly traceable from the investors to the purchase price, but Malakoff's collections from the investors always exceeded the installments paid on the purchase price.

On February 2, 1953, Malakoff commenced the delivery of stock certificates. He signed and delivered certificates to the persons who had given him money for investment in the market property, and he also signed and delivered certificates to others in payment of, or as security for, his personal debts arising from transactions not connected with the market property. All the shares issued by Malakoff were purportedly original issue. None of these shares had been paid for or acquired by Malakoff as an individual*.

The Court of Appeals has held that those persons who gave Malakoff money for investment in the market property are entitled to share in the Debtor's capital stock and that those who made no investment, but received certificates in payment of, or as security for Malakoff's personal indebtedness, are not.

Accordingly, the Court of Appeals determined that 33 claimants are to share in the capital stock of the Debtor in proportion to their investments, and that 8 other claimants, who made no investment, are not to share.

---

* Before the Debtor acquired title, twenty shares, represented by Certificates Nos. 1 and 2, were issued to the sellers of the property and were then all of the capital stock issued and outstanding. These two certificates, however, after transfer to Malakoff, were eventually surrendered by him to the corporation without the issuance of any certificates in substitution therefor, and, consequently, played no part in the determination of the present stock ownership.

Reasons for Denying Certiorari.

A. Petitioners, being non-investors, are not entitled to share in the capital stock.

Petitioners are among the non-investors. Holding certificates for which they did not pay, they propose, by a legal sleight of hand to establish their claims in equal rank with those who did invest. Their argument is as follows (Petition, pp. 25-28):

The Pennsylvania constitutional provision which forbids the issuance of stocks "except for money, labor done, or money or property actually received" is not self-executing. The corporation's only remedy when shares are not paid for is to assess the shareholders for the subscription price and, if it is not paid, foreclose on the shares pursuant to Purdon's Statutes 15, §2852-605. However, petitioners say, even this dubious remedy is now lost; when the stock claimants filed their claims, the Debtor in each instance counterclaimed for the par value of the shares and these counterclaims have now been dismissed. Thus, they conclude it is now *res judicata* that no one owes the subscription price. Hence, the non-investors are presented with their shares by courtesy of the Bankruptcy Court.

This reasoning not only reaches a fantastic result; it puts the cart before the horse. It is not the Debtor corporation which needs a remedy. These petitioners have filed claims seeking an adjudication that they have an interest in the Debtor's capital stock. Objections having been filed, they have the burden of establishing that they are entitled to such an interest. *Alexander* v. *Theleman* (10 C. A. 1934), 69 F. 2d 610, cert. den. 293 U. S. 581; *Rasmussen* v. *Gresly* (8 C. A. 1935), 77 F. 2d 252; *In re George R. Burrows, Inc.* (2 C. A. 1946), 156 F. 2d 640.

At the threshold, petitioners are met by Purdon's Statutes 15, §2852-603 A, which petitioners contend implements the Pennsylvania constitutional provision. That section provides in part: "Shares of a business corporation shall not be issued except for money, labor done, or money or property actually received".

But even if there were some quirk in the Pennsylvania law which could produce the fantastic result desired by petitioners, it is not Pennsylvania law that is being administered.

It is well settled that in passing upon claims the Bankruptcy Court is not bound by state law, but allows or disallows them upon equitable principles. *American Surety Co.* v. *Sampsell* (1946), 327 U. S. 269; *Heiser* v. *Woodruff* (1946), 327 U. S. 726; *Prudence Realization Corporation* v. *Geist* (1942), 316 U. S. 89; *Pepper* v. *Litton* (1939), 308 U. S. 295. In *In re V-I-D, Inc.* (7 C. A. 1952), 198 F. 2d 392, cert. den. 344 U. S. 914, the Court said (p. 396):

> "As we have shown in the quotations from the Supreme Court decisions cited above, bankruptcy courts were created by Congress for the purpose of administering bankruptcy matters and are governed by federal law. A bankruptcy court does not sit 'as another state court' and is not governed by state laws."

And in *Vanston Committee* v. *Green* (1946), 329 U. S. 156, the Court said by Black, J. (p. 162):

> "In determining what claims are allowable and how a debtor's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits. *Erie R. R.* v. *Tompkins*, 304 U. S. 64, has no such implication. That case decided that a federal district court acquiring jurisdiction because of diversity of citizenship should adjudicate contro-

versies as if it were only another state court. See *Holmberg* v. *Armbrecht*, 327 U. S. 392. But bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles."

In consonance with the above Supreme Court decisions, the Court of Appeals for the Sixth Circuit in *In re American Fuel & Power Co.* (1941) 122 F. 2d 223, appeal dismissed 322 U. S. 379, rejected a claim for stock interests in a debtor corporation, saying (p. 229):

> "In view of the remedial purpose of the provisions of the Bankruptcy Reorganization Act enlarging the category of provable claims, the statute is liberally construed in favor of claimants for whom relief was intended. Its object was to facilitate rehabilitation of embarrassed corporations by disallowing illegal or unconscionable stock interests or claims and by scaling or rearranging their obligations and shareholders' interests, thus avoiding a winding up, a sale of assets and distribution of the proceeds. City Bank Farmers Trust Company v. Irving Trust Company, 299 U. S. 433, 437, 57 S. Ct. 292, 81 L. Ed. 324. Under the Bankruptcy Act, the test of the provability of claims of creditors or the interests of stockholders is the actual existence of valid claims or interests. In re United Cigar Stores Company of America, 2 Cir., 83 F. 2d 202, affirmed by the Supreme Court in Meadows v. Irving Trust Company, Trustee, 299 U. S. 464, 57 S. Ct. 307, 81 L. Ed. 353.
>
> "The claim of a creditor or the interest of a stockholder which is invalid because it is based on or arises out of an illegal or criminal transaction, is not provable or allowable in bankruptcy reorganizations. [Citations omitted.]".

B. Allowance of the claims of those who invested after the completion of payments for the market property was proper.

Petitioners argue [Petition, p. 29] that the Court below could not properly set up a trust of the market property for the benefit of those investors who gave their money to Malakoff after the completion of the payments for the property by Malakoff on February 15, 1952. The status of these later investors, however, is entirely different from that of petitioners. They made a contribution intended for the venture, while the non-investors, including petitioners, made no contribution and did not intend to make any. If a traditional equitable ground of relief is necessary to support the stock claims of these later investors it is found in the principle of estoppel. The Debtor is estopped to deny them, since Malakoff was its president and thus authorized to represent it in receiving their payments. Resort to this basis of equitable relief, it may be noted, would be in accordance with Pennsylvania law. *Appeal of Kisterbock* (1889) 127 Pa. 601, 18 A. 381; *Krall* v. *Lebanon Valley Savings & Loan Association* (1923) 277 Pa. 440, 121 A. 405. The principle is also recognized in New York. *New York & New Haven R. R. Co.* v. *Schuyler* (1865) 34 N. Y. 30.

However, whatever law is applied, and whether the equitable principle is resulting trust, constructive trust or estoppel, the result achieved by the Court of Appeals in awarding the Debtor's stock to those who invested, and denying stock to petitioners who made no contribution, and had no intention of making any, is both equitable and just.

Conclusion.

The petition for Writs of Certiorari should be denied.

Dated: New York, N. Y.,
March 14, 1962.

Respectfully submitted,

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Supreme Court of the United States

October Term, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

In the Matter
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

BRIEF FOR PETITIONERS

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

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Supreme Court of the United States

October Term, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, *et al.*,

Respondents.

In the Matter
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

BRIEF FOR PETITIONERS

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit

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In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

Opinions Below

In No. 26362, the District Court for the Southern District of New York (*per* SUGARMAN, *D. J.*) rendered a memorandum opinion on January 4, 1960 (R. 43) and an opinion from the bench on June 14, 1960 (R. 479-504), and made

findings of fact and conclusions of law, dated November 7, 1960, and filed November 23, 1960 (R. 243-257); they are not reported. In No. 27000, said District Court made findings of fact and conclusions of law, dated and filed October 19, 1960 (R. 229-243); they are not reported, and there is no opinion. The opinions of the Court of Appeals for the Second Circuit (*before* MOORE, FRIENDLY, and SMITH, *Cir. JJ.*) in No. 26362 (*per* FRIENDLY, *Cir. J.*) (R. 572-584) and in No. 27000 (*per* MOORE, *Cir. J.*) (R. 586-600) are reported at 296 F. 2d 678 and 296 F. 2d 670 (respectively).[1]

Jurisdiction

The judgments of the Court of Appeals for the Second Circuit were made and entered on November 9, 1961 (No. 26362: R. 584-5; No. 27000: R. 600-1). Petitions for rehearing of both cases were filed by Petitioners Wolf *et al.* on November 21, 1961 (No. 26362: R. 585; No. 27000: R. 601), and were denied without further opinion on November 29, 1961 (No. 26362: R. 585-6; No. 27000: R. 601-2). The petition for writs of certiorari in both cases was filed on February 21, 1962, as No. 739, October Term, 1961, and was granted on April 2, 1962 (R. 602, reported at 369 U. S. 837). The jurisdiction of this Court rests on 28 U. S. C. § 1254(1).[2]

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[1] Petitioners have *not* sought review of a third companion case, No. 26962 (*see* R. 586-600). In addition, there have been five other appeals docketed in the Second Circuit Court of Appeals in these proceedings, *viz.*: No. 24564, reported at 249 F. 2d 221 (1957, *per* LUMBARD, *J.*); No. 25594, unreported (Debtor's appeal dismissed by Clerk for lack of prosecution, 1959); No. 26231, reported at 280 F. 2d 891 (1960, *p.c.*); No. 27248 and No. 27464, reported at 303 F. 2d 152 (1962, *per* SMITH, *J.*). (*See* 303 F. 2d *at* 153-4.)

[2] Arnold A. Weinstein, Jerome Fried, and Nazareth Fair Grounds & Farmers' Market, Inc. (the Debtor in possession, a nominal party) are Respondents in both No. 26362 and No. 27000. An additional Respondent in No. 26362 is Nazareth Enterprises, Inc. Additional Respondents in No. 27000 are all the beneficial owners of stock-claims besides the named Petitioners and Respondents.

Statutes Cited

The pertinent text of the constitutional provisions, statutes, and regulations which the case involves, is set forth in Appendix B, *infra*.

Questions Presented [3]

No. 27000

1. In a Chapter X reorganization proceeding, in adjudicating *claims* to stock interests in the debtor, which interests vested under state law prior to commencement of the reorganization proceedings and where no supervening federal statute or policy exists: Is the federal court (having *non-diversity* jurisdiction) required to apply *state rules of decision in equity?* If so, does the application of such state rules of decision extend to *remedies* as well as rights?

No. 26362

2. A Chapter X court has been petitioned to *remove* fiduciaries from office on the grounds of their personal trading in the debtor's stock *during* the reorganization proceedings and their diversions of the debtor's rents to themselves *during* the proceedings, and (on the same grounds) to deny them *compensation* out of the estate for services rendered by them *during* the proceedings. By statute, and as an equity receivership court, the Chapter X court has exclusive jurisdiction over the continued service of *all* fiduciaries and over the "reasonableness" of *all* compensation paid to *all* fidu-

[3] Questions 1, 2 and 3 presented here are identical to the three questions presented in the Petition for *Certiorari*. Questions 4 and 5 are subsidiary questions comprised in Questions 2 and 3, and are set forth for clarity and emphasis, pursuant to this Court's Rule 40(1)(d).

ciaries. In exercising that jurisdiction, is there a *double standard* which (a) requires the court to apply a strict *federal* standard of fiduciary conduct to those fiduciaries *alone* who were "disinterested" at the *commencement* of the proceedings, (b) yet permits the court to apply a different, looser *state* standard of fiduciary conduct to those fiduciaries who serve *during* the proceedings, but who were *not* "disinterested" at the *commencement* of the proceedings?

3. Does the payment of compensation to the officers of a Chapter X debtor in possession *week-by-week during* the proceedings, *exempt* such officers from the mandate and bar of § 249—that "No compensation or reimbursement shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold * * * stock [of the debtor] * * *."—although payment of compensation to such officers *in gross at the winding-up* of the proceedings, would be absolutely barred by § 249?

4. Assuming the mandate of terminating *future* weekly compensation under § 249: Does § 249 also mandate recoupment and restitution of *past* compensation paid out of the estate weekly during the Chapter X proceedings and prior to termination of future compensation?

5. Does a Chapter X court have power to remove from office a director or officer of a debtor in possession, on grounds of misconduct in office during the Chapter X proceedings?

Statement of the Case

The Debtor was incorporated in Pennsylvania on August 7, 1951, to operate a "farmers' market." Its sole assets are land and buildings at a highway junction in Nazareth, Pennsylvania. It rents space inside the buildings to merchants, and an outside race-track for stock-car racing. Its sole earnings are those rents (R. 44-5, 51).

The Debtor was organized by the "Philadelphia Group," a joint venture which had acquired the realty on April 17, 1951, and conveyed it to the Debtor on September 26, 1951, at their cost. The Debtor paid the Philadelphia Group part of the price by an original issue of 20 shares (of nominal book value, and the only outstanding stock until February of 1953). On October 17, 1951, the Philadelphia Group sold their entire interest (including the 20 shares) to John Malakoff, at a profit. From April of 1951, when he had bought a 1/4 interest in the venture, to 1952, Malakoff personally paid the Philadelphia Group, in irregular installments, most of the purchase price of the realty and the stock; eventually, they forgave him the balance due (R. 51-57, 230-1).

Malakoff undertook a clumsy real estate "syndication" or promotion.[1] Between April of 1951 and April of 1953, he sold "shares" in the Market to at least 41 persons. Every purchaser paid Malakoff personally (some by cash, some by check, some by credit against Malakoff's debts); he received substantially more from those purchasers than he paid the Philadelphia Group. In turn, Malakoff paid "dividends" to the purchasers, in regular monthly installments out of his own bank accounts, mostly computed at 20% per year on their original advances to him. Virtually all the transactions occurred in New York, where Malakoff and most of

[1] *See Symposium*, The Why and the How of Real Estate Syndications, 14 The Record of Assn. of Bar of City of N. Y. 45 *et seq.* (1959); Berger, Real Estate Syndication, 69 Yale L. J. 725 (1960).

the purchasers resided. The prices and other terms varied radically over the two-year period. Generally, the "shares" were described as $n/200$ of the Market; most were sold for $1,000 per "share," though some were sold for as little as $333 per share. Until the delivery of the stock certificates early in 1953, most of the purchasers held only letter-receipts from Malakoff as evidence of their payments and other terms of their transactions with him (R. 185-192, 231-2). Of the several forms used, the most common—drafted by respondent Weinstein, as Malakoff's lawyer (R. 123-5)—was the following:

> "You understand, of course, that *all of the authorized stock* of The Nazareth Farmers and Auction Market Inc. [*sic*] which owns the Market *has been issued to me*. Under our arrangements, I am obliged to you for a proportionate share of *my* earnings, dividends, liquidating or otherwise and profits from the Market as I receive them. For your information, I may say that the dividends have been declared at the rate of Twenty per cent. (20%) per annum, payable monthly. * * *
>
> "In the course of my management of the Market, I may cause to be issued to you shares *of my present stockholdings*. On the other hand, I may cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your shares will be applied as your contribution with a corresponding proportionate interest. At all events, the method of operation is to remain solely in my hands. * * *
>
> "It is contemplated that the construction, performance, and execution of our understanding shall be governed by the Laws of the State of New York." (R. 186-7; *emphasis supplied.*)

Not later than June of 1952, Malakoff took control of the Debtor. He became its president and a director; his employee, respondent Fried, became secretary-treasurer, a director, and general manager (R. 56, 154-7, 231). In August of 1952, Fried (acting for the Debtor as landlord) leased the race-track to Fried's then-partner for ten years; in April of 1953, Fried's corporation (Nazareth Enterprises, Inc.) took over the lease as tenant (J. Fried Creditor; Margolis's Exh. C, R. 560, 7413; Examiner's Exh. 1, R. 556, 8333).

By early 1953, Malakoff was in financial trouble. Between February and April, he caused the Debtor to issue and deliver stock certificates (co-signed by Malakoff and Fried) to evidence the "shares" Malakoff had sold. The Debtor's charter authorized the issuance of 200 shares, and Malakoff had represented the "share" total as 200; in fact, he oversold, and he caused the issuance of at least 316 shares (R. 57, 185-7, 232).

By May of 1953, Malakoff's "dividend" checks had stopped. The stockholders, previously dormant, then interceded. In June, Malakoff surrendered his own stock (the original 20 shares) to the Debtor, and Malakoff and Fried resigned as officers and directors. At a stockholders' meeting on June 29, 1953, Weinstein was elected president and a director. He continued Fried's service as general manager (R. 187-9).

The Debtor was and is solvent in the bankruptcy sense. The major problem was to determine the ownership of the Debtor's stock (R. 1-14; Examiner's Exh. BY; R. 516-524, R. 9587). In effect, in order to resolve that problem, the Debtor selected the Chapter X court as a convenient forum with sweeping jurisdiction over all 11 parties and the subject matter.

On September 28, 1953, on a voluntary petition verified by Weinstein as president, the Debtor entered Chapter X reorganization proceedings in the Southern District of New

York (R. 1). The *ex parte* orders signed that day continued the Debtor in possession, provided that the Debtor:

> "by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of"

the Debtor, and authorized payment of a salary of $100 per week to Fried as general manager (R. 11-12, 15, 17). Later orders in 1955 and 1956 increased Fried's salary to $150 and then $200 per week, and authorized a salary of $50 per week to Weinstein, too (R. 21, 23, 38). Their weekly paychecks, like all other checks drawn on the Debtor's regular checking account, are countersigned by a referee in bankruptcy, Hon. John E. Joyce (R. 18, 247).

The Parties: Petitioners Wolf and Davidson are the nominal owners and holders of 117 shares of stock of record of the Debtor; their principals include Wilson D. Rehrig, Martin H. Philip, and Petitioner Katzenell, the beneficial owners. Between June 27, 1957, and December 9, 1960, Wolf and Davidson acquired those 117 shares from eight stockholders of record, namely: Petitioners Hull and Katzenell, and S. Forman, Kane, Kanter, Pollak, and Saul; Katzenell retained a partial interest in his own shares, and acquired a partial interest in the Kanter shares (R. 49, 195). (Petitioners and their principals are sometimes collectively referred to in the proceedings and in this brief as "Wolf" and the "Rehrig Group".)

Respondents Weinstein and Fried are stockholders of record who first acquired shares from Malakoff in 1951 (R. 120, 156). Beginning on May 7, 1957, Weinstein and Fried acquired for themselves and for Laupheimer and Mrs. Blanche Waldman (Weinstein's sister) 35 shares of stock of record from six stockholders, namely: B. Clark, D. H. Clark, Karapontso, Manoochehrian, Masur, and Treat (R. 441-2, 290-4, 470). Beginning January 26, 1961, Fried's associate, Frank V. Thompson (R. 470), acquired 31 shares

of stock of record from seven stockholders, namely: Bikales, Bluestone, H. Forman, Noire, G. Schwartz, H. Schwartz, and T. J. Schwartz. Weinstein, Fried, Fried's father (Aaron), and Laupheimer own 21 shares of record acquired from Malakoff prior to 1953. Thus, the "Weinstein-Fried Group" now own an aggregate of at least 87 shares of record.

The Debtor is governed by a board of three directors, elected by cumulative voting by the stockholders. On June 29, 1953, the Debtor's stockholders of record elected Weinstein, Kanter, and Margolis directors. On August 24, 1953, Margolis resigned, and the directors substituted Laupheimer as the third director. (Saul General: Examiner's Exh. 1; R. 168 [not printed].) Weinstein, Kanter, and Laupheimer continued to serve as directors after the Chapter X proceedings commenced. The next election was called by petitioners and was held on August 4, 1958; the stockholders of record elected Weinstein, Philip, and Danciger directors. That election was not confirmed by the District Court until June 14, 1960[2] (R. 226-7, 495-6).

The controversy in No. 27000 involves the relative distribution of the Debtor's shares—equity and votes—between the two factions. The Rehrig Group's 117 shares of record as issued in 1953, are 37.025% of the total 316 shares of record; the Weinstein-Fried Group's 87 shares are 27.532% of those 316 shares. Under the District Court's order of December 8, 1960, and assuming the same allowances to the Margolis Group as made by the Court of Appeals, the Rehrig Group would hold 31.107% of the Debtor's stock, and the Weinstein-Fried Group would hold 34.474%. Under the Court of Appeals' decision of November 9, 1961, the Rehrig Group would hold 19.591% of the Debtor's stock, and the Weinstein-Fried Group would hold 38.188%.

In No. 26362, petitioners have proceeded representatively, as stockholders; by contrast to No. 27000, No. 26362 is in

[2] See Bankruptcy Act § 191, 11 U. S. C. § 591, 52 Stat. 893 (1938).

the nature of a derivative suit brought on behalf of the Debtor against Weinstein and Fried *qua* corporate fiduciaries.[6]

The bitter contests between the two factions began shortly after August 28, 1956, when a fire virtually destroyed the Nazareth Market. Rehrig was a tenant of the Debtor in the Market before the fire, and afterwards until June 13, 1962, when fire (the third during these proceedings) again destroyed the portion of the Market occupied by Rehrig. The disputes over management and Rehrig's tenancy were summarized by Judge Sugarman in his findings of November 7, 1960:

> "During the course of the ensuing proceedings certain disputes arose between the management of the debtor and a group of alleged shareholders, colloquially referred to as the 'Rehrig group', stemming from the alleged refusal of the management of the debtor to give Rehrig, a meat merchant in the market, fair consideration as to space, rental, etc. Control of the debtor was sought to be obtained *by each side* by an acquisition of the interests of various putative stockholders." (R. 246; emphasis supplied.)

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[6] Bankruptcy Act, § 206; 11 U. S. C. § 606; 52 Stat. 894 (1938).

In 1955 and 1956, the District Court issued "bar orders"[7] which compelled all the stockholders to file proofs of claim to stock interests in Nazareth (R. 45, 229). The Debtor's answers (verified by Weinstein as president) objected to the allowance of every single stock-claim and asked cancellation of all the stock. Alternatively, the Debtor counterclaimed for the subscription price of any stock which might be validated (*Id.*; *see, e.g.*, R. 177). Malakoff had died, insolvent, in 1955; he was never a party to the Nazareth proceedings.

Those bar orders also referred the stock interests and creditors' claims to John E. Joyce, Referee in Bankruptcy, to hear and determine. In 1957, Referee Joyce tried the five stock-claims of the "Margolis Group" alone.[8] On March 18, 1958, Judge Sugarman revoked the general reference to Referee Joyce with respect to the 36 stock-claims (as well as six creditors' claims) then still undetermined by Referee Joyce.[9] Judge Sugarman consolidated those claims, and himself undertook trial thereof. The trial consumed 86 trial-days between May 19, 1958, and May 7, 1959; more than 50 witnesses testified; the stenographers' minutes aggregate 9638 pages; the exhibits fill several file drawers (R. 2456).

On October 3, 1956, the District Judge had appointed Charles Seligson Examiner in the Nazareth proceedings (R. 46).[10] The Examiner actively participated in examining wit-

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[7] See Bankruptcy Act, § 196; 11 U. S. C. § 596; 52 Stat. 893 (1939); *see also*, 6 Collier on Bankruptcy (14th ed.) ¶¶ 9.03, 9.04.

[8] The "Margolis Group" (viz., Benjamin Margolis [recently deceased], Ida Mae Margolis, Sarah Kason, Wm. McK. Shongut, and Bernard Ungar) were five of the 41 stockholders of record who had filed proofs of stock interests in 54 shares. *See* No. 26862, R. 586, 597-8.

[9] *Pursuant to* Bankruptcy Act, § 168; 11 U. S. C. § 568; 52 Stat. 888 (1938). Charles Seligson is Professor of Law at New York University, and is a member of the Supreme Court's Advisory Committee on General Orders in Bankruptcy. (184 F. Supp. 7.)

nesses and introducing evidence at the trial before Judge Sugarman; moreover, on April 19, 1960, after the parties had submitted their briefs, the Examiner submitted a 236-page Report, which reviewed the evidence and which recommended findings of fact and conclusions of law (R. 44-217). On October 19, 1960, Judge Sugarman filed his findings and conclusions (R. 229); and on December 8, 1960, Judge Sugarman signed an order thereon (R. 260). The District Judge treated the Examiner's Report as a master's report, and adopted the Examiner's recommended findings and conclusions—but only after the District Judge's own independent and thorough review of the record (R. 492, 245-6). Subsequently, the Court of Appeals likewise treated the Examiner's Report as a master's report adopted by the District Court (R. 590, 593, 594).

The District Court's Order of December 8, 1960, allowed *all* 36 stock-claimants to participate in the estate, according to the "net fair value" of their respective "investments" (*i.e.*, their advances to Malakoff, less "dividends" received). That Order also denied all 36 of the Debtor's counterclaims for the stock subscription prices (R. 260-4).

Three appeals were taken, by Weinstein and Fried (each acting individually) and by Petitioners. Weinstein's appeal sought disallowance of the three stock-claims of Kanter, Katzenell, and S. Forman (owned by the Rehrig Group). Fried's appeal sought disallowance of those three stock-claims and a fourth, Danciger's. Wolf's appeal sought a different formula of distribution, not a disallowance of particular stock-claims (R. 13566-70 [*not printed*]). The Debtor did not appeal; however, on Weinstein's authorization, the Debtor, as appellee, attacked the District Court's allowance of 10 of the 36 claims involved in No. 27000, including the four claims involved in the Weinstein-Fried appeals. Neither the Debtor nor any other party appealed from the denial of the Debtor's counterclaims for the stock subscription prices (by contrast to the allowances and awards of stock interests).

On November 9, 1961, the Court of Appeals reversed the District Court, and effectually adopted the rationale of Weinstein, Fried, and the Debtor (*see* R. 47-49, 192-4). The Court of Appeals set up two classes of stock-claimants. Five stock-claims (Danciger, H. Forman, S. Forman, Katzenell, and Manoochehrian), and most of a sixth (Kanter), were disallowed; that stock was cancelled. The other 30 stock-claims were allowed according to the respective sums advanced to Malakoff, but without deduction of "dividends" (R. 586-600).

In sum, both the District Court and the Court of Appeals, purporting to apply Pennsylvania corporation law, held *all* the Debtor's outstanding stock absolutely void for lack of consideration to the Debtor. Then, on general principles of "equity," without further reference to state law, and as though there were no corporation, both courts undertook to distribute the assets of the Debtor anew. Shares of stock were to be issued proportionate to the prevailing stock-claimants' equitable "interests" in the Debtor's assets. Free of any applicable *law*, the courts below differed substantially in their respective views of the facts and the "equities."

The evidence and findings of particular materiality are as follows:

1. *Debtor's Acquisition of Market:* The Philadelphia Group[10] obtained an option to the Market on March 13, 1951, and purchased the Market on April 17, 1951, for an adjusted net cost of $66,232.99; the nominal purchaser was Richard Realty Co., a corporate "dummy" for the joint venture. They re-conveyed the Market to another Philadelphia Group corporate dummy, Kipling Realty Co., on May 14, 1951. They had advanced $47,732.99 in cash at and before the closing, and assumed liability on two mortgages; later,

[10] The "Philadelphia Group" included Maurice Malakoff (John's brother), Edward Malakoff (Maurice's son), Milton R. Zoloth (Edward's brother-in-law), and Morris Soble. Zoloth and Soble became the first two Nazareth stockholders. (R. 52-3, 280-7)

they advanced additional moneys for improvements, opening bank deposit, *etc.*, and they deducted depreciation, amortization, operating deficits, *etc.*, from their capital account. As of August 7, 1951, their net cash investment in the Market was $58,635.92, which they had recapitalized to show $57,135.92 in "loans" owed to individual members, and $1,500 in "capital" (R. 51-3, 230-1, 282-3, 286-7, 588; Saul General Examiner's Exh. G, R. 531, 156; Exh. J., R. 537; Exh. BU, R. 507; Exh. BY, R. 511-2, 9587).

On August 1, 1951, the Philadelphia Group organized the Debtor; the certificate of incorporation was issued in Harrisburg on August 7, 1951. The articles of incorporation show "stated capital" of $120,000, and "paid-in capital" of $1,500. On August 9, 1951, the Debtor—controlled by the Philadelphia Group—agreed to buy the Market from Kipling (the venture's dummy) *at Kipling's cost.* The adjusted book value (cost) of the Market was then $75,227.39. The consideration for the Market was twofold: (a) the Debtor's issuance of 20 shares of stock to the Philadelphia Group, capitalized at $1,500, and (b) the Debtor's assumption of certain liabilities owed by the Philadelphia Group, including the two mortgages owed to third parties and the $57,135.92 in "loans" owed to its own members. On August 8, 1951, 20 shares of the Debtor's stock were duly issued to Soble and Zoloth (members of the Philadelphia Group). On September 26, 1951, pursuant to the August agreement, the Market was conveyed to the Debtor (R. 53-5, 231, 588-9; Saul General Examiner's Exh. I, R. 532-4, 168; Exh. BY, R. 512-3, 9587).

The Debtor, as a separate corporate entity, *never* had any obligation to the Philadelphia Group or to Malakoff for any profit, promotional services, or goodwill incident to the conveyance of the Market to the Debtor.

2. *Malakoff's Interest:* In March of 1951 (between contract and closing) the Philadelphia Group sold John Malakoff a 1/4 interest in the venture. By August 7, 1951, he had advanced $17,489 to them, which sum was included in the

$57,135.92 in "loans payable" by the venture and later by the Debtor (R. 51-2, 56, 230; Saul General; Examiner's Exh. J., R. 537; Exh. BU, R. 507; Exh. BY, R. 512-3, 9587).

In July of 1951, the Philadelphia Group agreed to sell the entire Market to Malakoff (R. 52, 231, 588). The transaction shows their financial sophistication. The sale was consummated on October 17, 1951—precisely six months after their acquisition of the Market on April 17th. The contract spoke only of the 20 shares of Nazareth stock then issued and outstanding and owned by Soble and Zoloth (as members of the Philadelphia Group). The purchase price of the stock—capitalized at $1,500 on the Debtor's books—was $32,853.08, payable $2,853.08 down on contract, and the balance in ten equal monthly installments of $3,000 each—thus spread over two fiscal periods (R. 55, 231, 588; Saul General; Debtor's Exh. F, R. 540-1, 90). In addition, Malakoff personally assumed liability to the Philadelphia Group for the "loans payable" to them; by June 30, 1952, the Debtor's books showed those loans as owed to Malakoff himself, and the Philadelphia Group had discharged their claims against the Debtor (R. 56; Saul General; Examiner's Exh. BY, R. 514, 9587). On or about October 17, 1951, the two stock certificates for the original 20 shares were duly indorsed in blank by Soble and Zoloth. As security, the Philadelphia Group retained those stock certificates, and the entire corporate outfit as well, in escrow or purchase-money pledge (R. 55-6).

The District Judge found that the total price of the Market to Malakoff was $66,000 (the contractual purchase price of the Market to the Philadelphia Group in April) "plus an unresolved amount" (R. 231). The Examiner found that the total price to Malakoff was $89,989 (*i.e.*, $32,853.08 for the stock, plus $57,135.92 in "loans" owed by the Debtor and assumed by Malakoff *vis-à-vis* the Philadelphia Group [including the $17,489 actually advanced by Malakoff and invested in Nazareth prior to August 7th]) (R. 52, 56). The

upshot was an intended profit to the Philadelphia Group of about $30,000—all payable by Malakoff on the sale of the stock, and none payable by the Debtor on the sale of the realty.

In 1951 and 1952, Malakoff paid the Philadelphia Group $60,521.84, in irregular installments: $17,489 between April and August of 1951; $17,500 between September 13 and October 16, 1951; $14,500 between October 24, 1951, and February 15, 1952; and $11,032.84 in September and October of 1952 (R. 56-7; Saul General: Examiner's Exh. J, R. 537-9). Malakoff was always in arrears on his contractual installment obligations. Nevertheless, the Philadelphia Group did not foreclose the pledge; indeed, when they released the stock certificates and corporate outfit, in December of 1952, they forgave Malakoff the balance then due to them, almost $30,000—their entire anticipated contractual profit on the transaction (R. 57).

On June 17, 1953, Malakoff resigned as president and a director of Nazareth (R. 188). That day, he surrendered *to the Debtor* the original 20 shares he had purchased from the Philadelphia Group (Soble and Zoloth) in October of 1951. He indorsed the stock certificates:

> "I hereby assign the within certificate/shares to the corporation. /s/ John Malakoff"

(Saul General: Examiner's Exh. H, Ctfs. 1, 2; R. 166 [*not printed*]; R. 185-6). By then, Malakoff had already caused the issuance and delivery of all the outstanding stock certificates for 316 shares to all 41 stock-claimants (R. 186).

As of June 30, 1953, the Debtor's books showed receivables from Malakoff to the Debtor of $15,710.63, and loans payable by the Debtor to Malakoff of $68,442.92; *i.e.*, net payables owed to Malakoff of $52,732.29 (R. 57; Saul General: Examiner's Exh. BY, R. 518, 9587). Between November of 1951 and April of 1953 (the entire period of Malakoff's control

of the Debtor), Malakoff had personally advanced $21,389.43 to the Debtor, and had withdrawn $22,510.33 from the Debtor, for a net debit of $1,198.90. The record shows no compensation or other payments to him except the aforesaid withdrawals (Saul General: Debtor's Exh. L; R. 549-551). From April of 1951 through June of 1953, the Debtor maintained a regular checking account at a Nazareth bank, which account is reflected on the Debtor's books. There was no commingling of funds of the Debtor and Malakoff, except as shown in the loan and exchange accounts between the Debtor and Malakoff on the Debtor's books (R. 189, 191-2).

On July 2, 1953, Malakoff released all his claims against Nazareth (R. 57; Saul General: Debtor's Exh. Q, R. 554-6, 8899). It was not until fiscal 1957 that the Debtor's management effectuated that release on the books by "vacating" the $68,442.92 in loans payable to Malakoff, with this explanation by the Debtor's accountant:

> "* * * Upon investigation, the officers of Debtor have determined that said sum was primarily a bookkeeping entry, not a true indebtedness. * * *"

The sum was credited to *earned surplus*, not to paid-in capital; and the receivables of $15,710.63 still appear on the Debtor's books as owed by the insolvent, deceased Malakoff (Saul General: Examiner's Exh. BY; R. 518, 522, 9587).

3. *Valuation:* The record contains no appraisal or expert valuation of the Market, the realty, or the capital stock of the Debtor at any time, nor any judicial valuation.

4. *Variation of Investment Contracts:* Malakoff's relationship with the 41 stock-claimants varied materially from the time he first became interested in Nazareth in March of 1951 until his last delivery of stock certificates in May of 1953. Until December of 1952, when the Philadelphia Group released the stock-certificate book, Malakoff could not deliver stock certificates to his investors. Instead, he used a variety of letter-receipts (R. 186-7).

(a) In March and April of 1951, when Malakoff had a $\frac{1}{4}$ interest in Nazareth, he invited at least six investors to participate. His estimated cost of $\frac{1}{4}$ was $12,000 (he advanced $12,489 of the $47,732.99 cash outlay by the Philadelphia Group to close title on April 17, 1951). To allow for his own promotional share, he used a base of $16,000. Three of those investors remain stockholders at present, *viz.*: Kanter, G. S. Klein, and Samet, who contributed $4,000, $2,000, and $2,000 (respectively), for which Malakoff promised them $\frac{1}{4}$, $\frac{1}{8}$, and $\frac{1}{8}$ of his $\frac{1}{4}$ interest, or $\frac{1}{16}$, $\frac{1}{32}$, and $\frac{1}{32}$ of the venture (respectively) (R. 230, 56, 60, 64, 67; Saul General: Debtor's Exh. K; R. 547). Those transactions were characterized by a letter Malakoff wrote to Samet much later, on June 12, 1952:

> "It is understood that you have invested in the sum of two thousand dollars ($2,000.00) which is a part share ($\frac{1}{32}$) in a deal, which is known as 'Nazareth Market' * * *." (R. 64)

(b) In July of 1951, when Malakoff agreed to purchase the entire Market from the Philadelphia Group for about $90,000, he began to sell participating interests or shares of 1/200 at $600 per share; 150 of the 200 shares would yield the purchase price of $90,000, and leave him $\frac{1}{4}$ as his promotional share. This arrangement was characterized by his letter-receipt to Katzenell, on September 4, 1951:

> "I hereby confirm receipt of amount totalling Thirty Thousand ($30,000.00) for $\frac{1}{4}$ share of Farmers Market at Nazareth (50 shares of total of 200 issued)." (R. 178)

(c) About August of 1951, with the prospect of inviting investments from strangers, Malakoff promised, not only "participation" in Nazareth, but income of 20% per year, payable monthly; and he raised the price to $1,000 per share. Now he used a new form of handwritten letter-receipt, which spoke of an "escrow" of moneys received; *e.g.*:

> "Please be advised that I am holding in escrow the sum of Four thousand dollars which represents one-fiftieth (1/50th) ownership in the Nazareth Farmer's & Auction [*sic*] Market, in Nazareth, Pennsylvania.
>
> "At the present time the return on your investment is twenty per cent (20%) per annum, payable monthly. As the net income increases your return will increase proportionately." (Masur: Cl's 81; R. 566, 390; *See* R. 79)

(d) About mid-September of 1951, Malakoff abandoned the "escrow" form and began to use the "long-form" letter-receipt for most of the stockholders; many of the prior investors, too, later received that form. Typically, that form read as quoted above on page 6.

(e) Eventually, between February and May of 1953, the stockholders all received stock certificates from Malakoff; and Malakoff stopped using any form of letter-receipt. Some of those late-comers who took stock certificates as security for loans to Malakoff, as payment for antecedent debts by Malakoff, or in exchange for other investments obtained from or through Malakoff, had special written agreements. The late-comers who paid cash, received nothing but the stock-certificates, some (though not all) of which were indorsed with Malakoff's guaranty; *e.g.*:

> "This certificate represents two $1,000 shares ($2,000—). At the present time the dividend is guaranteed at 20% per annum payable in equal monthly instalments on the first day of each month. /s/ John Malakoff." (R. 82)

Thus, there was no single scheme followed by Malakoff over the two years of his Nazareth adventure. The price of the stock, the time of investment, the written agreements, the return in "dividends", the type of consideration: all varied substantially; and in several instances Malakoff changed his

investment contracts with the claimants. Moreover, when the stock certificates were actually issued and delivered, neither the dates nor the numbers on the certificates were correlated to the sequence of investments or agreements with Malakoff. The Examiner stated that it was impossible to identify which of the issued shares fell within the "over-issue" (R. 210-24); and neither the District Court nor the Court of Appeals made any finding or conclusion identifying the "overissue". Finally, both Courts below focused on the cash "investments" made by the stock-claimants, and disregarded their agreements with Malakoff.

5. *Tracing of Funds—Intentions of Stock-Claimants—Malakoff's Capacity.* There are two major factual discrepancies between the findings of the Court of Appeals and the findings of the District Court.

(a) The District Court found that *all* the stock-claimants had dealt with Malakoff *individually*. By contrast, the Court of Appeals found that the prevailing stock-claimants had dealt with Malakoff *representatively* (*i.e.*, as *trustee* for those stock-claimants), and that those stock-claimants who had dealt with Malakoff *individually* were entitled to nothing.

(b) The District Court found that the stockholders' advances had all been commingled in Malakoff's bank accounts with other moneys (*i.e.*, moneys of his own and moneys of investors in transactions other than Nazareth), and that tracing of their advances into or for the Nazareth Market was unproved and impossible on the record (except $8,000 advanced by Kanter, G. S. Klein, and Samet in March and April of 1951, and paid over to the Philadelphia Group [R. 56, 230]). By contrast, the Court of Appeals found that the purchase price of the Nazareth Market (paid by Malakoff to the Philadelphia Group) could be, and actually had been, traced to the *prevailing* stock-claimants' advances to Malakoff, but could *not* be so traced to moneys advanced to Malakoff by the *disallowed* stock-claimants. Moreover, the Court of Appeals did not distinguish between the earlier

advances *actually* so traced, and the later advances which should have been—but had *not* actually been—so identified with the purchase price or other corporate purposes.

Judge Moore stated the findings of the Court of Appeals, as follows:

> "* * * One group of investors paid Malakoff by check, credit or cash various sums to purchase an interest in the Nazareth Market. The money was solicited *for this purpose* by Malakoff *as the promoter* of the enterprise and was *not intended* to be loans to Malakoff personally or to be used generally by him in his many business operations. The funds *should have* reached the Debtor's treasury and have been the consideration required by Pennsylvania law [footnote] to support the valid issuance of the Debtor's shares. * * *". (R. 591; *emphasis supplied*)

> "* * * The Market property is sufficient to support a valid stock issue to those entitled thereto. The sellers (Philadelphia group) have been paid for that property *by Malakoff*. Malakoff in turn obtained the money *for this purpose* from those who *thought* that they were to receive an interest in the Nazareth Market. * * *" (R. 592; *emphasis supplied*)

> "Although the findings of fact of the Examiner may be accepted almost in their entirety, his conclusions are at variance with the equitable principles applicable here. The *Examiner treated Malakoff as the owner* and operator of the Debtor and *each claimant as having purchased his interest from Malakoff*. This *erroneous assumption* made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory the stock transfers from Malakoff rested upon adequate consideration if the Stock Transfer Act's defi-

nition of 'value' were satisfied. * * *." (R. 593; *emphasis supplied*)

The findings of the District Judge include the following:

"13. Every claimant acquired his or her shares of the debtor's stock by means of transactions with or through said John Malakoff or his agents." (R. 231)

"14. John Malakoff commingled funds received by him from others for investment in the debtor with *his own funds* and with those of other corporations controlled by him." (R. 231; *emphasis supplied*)

The findings of the Examiner include the following:

"90. There are certain findings and conclusions of *fact* which the Examiner deems significant in determining the principles and rules of law which should be applied in the determination of the question as to who are the stockholders of the debtor corporation. Those findings and conclusions are beyond cavil and can be stated without qualification. They are as follows, * * *:" (R. 190)

"(8) *None of the payments* made by any of the claimants-stockholders, representing investments in Nazareth, *was made directly to the debtor*. Almost all of the checks were drawn or endorsed over to Malakoff or Helen Bernstein [Malakoff's assistant]. *There is nothing in the record which establishes that any of these payments became an asset of Nazareth even indirectly.*" (R. 192; *emphasis supplied*)

"92. * * * The [Debtor's (*i.e.*, Rosen's)] memorandum, however, argues that Malakoff acquired an interest in Nazareth for the account of those who invested in Nazareth through him. Therefore, so the argument runs, an interest in Nazareth may be predi-

cated only on the basis of a *present consideration* given to Malakoff for the *express purpose* of acquiring an interest in Nazareth. This conclusion does not necessarily follow from the premise that Malakoff purchased an interest in Nazareth for the account of those who invested in Nazareth through him. Since Malakoff and not the debtor was the direct recipient of all consideration paid for all of the shares of stock issued to the claimants-stockholders, and *no claimant has attempted to trace, from Malakoff to the debtor, the consideration he or she paid to Malakoff*, none of the claimants-stockholders can prove that he acquired any of the shares in strict conformity with law." (R. 193; *emphasis supplied*)

The extent to which the relevant findings of the District Judge and the Examiner depended upon the credibility of the witnesses, and particularly the stock-claimants themselves, may be seen in the case of Weinstein himself. Weinstein had bought seven shares of Nazareth stock in September of 1951 (R. 120). He not only received the "long form" letter-receipt (R. 186-7, *quoted supra*, p. 6); as Malakoff's lawyer, he had drafted that form (R. 122-5). In 1955, Weinstein filed a sworn proof of claim, alleging:

> "That John Malakoff, the then President of the Debtor, and as such, fraudulently represented to Claimant on or about the 12th day of September 1951, that he was the President of the Debtor Corporation, that the said Corporation was authorized to issue Two hundred (200) shares of stock, that said stock was duly *issued to him* and that 7 of *such* shares were being *sold to Claimant* for $7,000.00. On the basis of the foregoing representations, deponent issued his check to John Malakoff as above stated on or about the 19th day of September 1951 * * *." (R. 120; *emphasis supplied*)

Nevertheless, in 1958, upon interrogation by the District Judge, Weinstein testified:

> "Q. Mr. Weinstein, I think you understand me. Leaving out the fact that there was indecision at that time as to what future form the enterprise would take, I ask you as a lawyer who drew that document what you believe any reasonable person would get, what impression they would get, as to the ownership of a venture by reading the second paragraph in the language that you coined. A. The impression that somebody would get, your Honor, is that John Malakoff had had all of the stock issued to him and that he owned it.
>
> "Q. And that he was selling it, is that right, in some form? A. Yes, sir.
>
> "Q. But am I to understand your testimony to be that, notwithstanding the employment of that language in that agreement, the impression that you got from John Malakoff was different? A. Yes, sir." (R. 362-3).

6. *Dividends:* Beginning about September of 1951, Malakoff paid "dividends" of 20% per year to most (though not all) of the stock claimants, usually (though not invariably) based on the actual cash advances made by the stock-claimants to Malakoff for investment in Nazareth. The "dividends" continued until May of 1953, though some of the checks were dishonored as early as March due to insufficient funds. Those "dividends" were paid out of Malakoff's personal checking accounts, except during February and March of 1953 when they were paid out of a corporate account separate from the Debtor's regular account and fed entirely by Malakoff (R. 189-192, 232).

The District Court treated those "dividends," paid out of Malakoff's personal moneys, as "return of capital," and

deducted the aggregate receipts by the stock-claimants from their advances to Malakoff in determining each "net cash investment" in Nazareth (R. 209-212, 241, 262). By contrast, the Court of Appeals treated the "dividends" as trust funds traceable to the prevailing stock-claimants' advances to Malakoff, and as diversions of corporate funds; the aggregate receipts by the prevailing stock-claimants were *not* to be deducted from "capital" or investment in Nazareth, but were to be recouped by the Debtor from the stockholders by offset against future "distributions" payable by the Debtor (R. 598-9).

Judge Moore wrote:

> "* * * These 'dividends' were paid in Ponzi-like [footnote] manner out of new money *received from investors* in the Nazareth Market. * * *" (R. 590; *emphasis supplied.*)

(By "investors," Judge Moore meant the prevailing stock-claimants alone. *See* R. 591, 593-4, 598-9.)

By contrast, Judge Sugarman found:

> "17. The so-called dividends received between August 7, 1951 and September 28, 1953, both dates inclusive, by the *persons who acquired legal or beneficial interests* in the debtor represented the return to them by John Malakoff *individually*, directly or indirectly, of moneys advanced by such persons, directly or indirectly, for or against their respective interests in the debtor." (R. 232; *emphasis supplied*)

And the Examiner found:

> "(7) The dividends aggregating $36,268.02 paid to the stockholders, with the exception of some dividends paid to stockholders in February and March of 1953,

> represented payments made by Malakoff from one of his personal bank accounts and *did not come from Nazareth directly or indirectly.* In February and March 1953, dividend checks were issued by Nazareth on the Second National Bank of Nazareth, Pennsylvania. The deposits in and the disbursements from this bank account were unrelated to the regular operations of the corporation. The funds deposited were supplied by Malakoff." (R. 191-2; *emphasis supplied*)

(Judge Sugarman and the Examiner, of course, are speaking of all 36 stock-claimants, not the "investors" alone.)

7. *Stockholders' Non-Participation in Malakoff's Frauds*: The District Court found:

> "12. * * * throughout the entire period of all the transactions involved in the issuance of stoc to the stock claimants herein, the debtor was dominated and controlled by him [Malakoff]." (R. 231)

Neither Court below found that any of the 36 stock-claimants involved in No. 27000 had participated with Malakoff in any fraud he perpetrated on the Debtor or on the stockholders. Neither Court found that any of the 36 stock-claimants had any actual knowledge of any such fraud until Malakoff confessed and resigned in May and June of 1953. In at least two instances, the Examiner *explicitly* found *no* such participation, *viz.*: Kanter (R. 62) and Hull (R. 146) (two of Wolf's assignors).

No. 26362

During the reorganization proceedings, Weinstein and Fried engaged in two courses of conduct which became the subject of Wolf's petitions in No. 26362, *viz.*: (1) For their own accounts and for others, they bought and sold the Debtor's stock. (2) They reduced the percentage rent payable by Fried's race-track corporation to the Debtor on the race-track gross receipts (under the lease made by Fried in 1952); and they arranged for Fried's corporation to retain the rents theretofore paid by a race-track food concessionaire to the Debtor. Here, unlike No. 27000, the facts material to No. 26362 are undisputed.

Having been stockholders, directors, and officers of the Debtor, Weinstein and Fried were not "disinterested" at the commencement of the proceedings.[11] A preliminary issue in No. 26362 is whether Fried, as the Debtor's "general manager," is a "fiduciary."

The relief sought by Wolf in No. 26362 is denial of compensation by the Debtor (*i.e.*, out of the estate) to Weinstein and Fried, and their removal from office as president and director and as general manager (respectively). The first of Wolf's two petitions came on in March of 1959 (during the stock-claims trial), and was addressed solely to denial of compensation; Wolf alleged only the trading in the Debtor's stock, and relied principally on § 249 (R. 247, 254). On January 4, 1960, the District Judge decided that § 249 mandated termination of future compensation to Weinstein and Fried—but that § 249 did not mandate recoupment of their salaries already paid, the latter issue being within the Chapter X court's discretion in equity. Trial on that latter issue was set for later in January (R. 45, 248-9). Thereupon, Wolf brought the second petition (R. 217), which added the race-track rent diversions as grounds for equitable recoup-

[11] Bankruptcy Act, § 158; 11 U. S. C. § 558; 52 Stat. 888 (1938).

ment of past compensation, and which added the prayer for removal from office on all the same grounds (R. 248, 255). A four-day trial ensued, between January 25 and 28, 1960, on both petitions, as consolidated. Meanwhile, no order was entered on the January 4th decision (R. 247-8, 255).

On June 14, 1960, the District Judge ruled, and rendered orders, on the two petitions in No. 26362. He terminated the future compensation of Weinstein and Fried—solely on the ground of their trading in the Debtor's stock, and solely on the authority of § 249—and he barred them from actively serving as president and director and as general manager (respectively).

> "The Court: I refuse to entertain any idea that will permit you [Fried] to have anything to do with the debtor, because you dealt in the debtor's securities and Congress said you cannot be compensated if you deal in the debtor's securities. Also I say that I will have nobody working in that Market without compensation or having his compensation paid by somebody else. That is a unique situation. I will have no part of it." (R. 502)

However, the District Judge declined to order recoupment or restitution of past compensation; and he deemed himself powerless to remove Weinstein and Fried formally from office (R. 249-252, 257, 494-6, 498, 501-2).

Weinstein, Fried, and Wolf cross-appealed (R. 573). On July 12, 1960, the Court of Appeals granted Weinstein and Fried a stay, pending appeal, of their *de facto* removal from office, though not of the termination of their salaries (R. 576-7, 244). On November 9, 1960, the Court of Appeals reversed the District Court both as to denial of their compensation and as to the *de facto* removal of Weinstein and Fried from office. The Court of Appeals held § 249 inapplicable, as a matter of law, and found no breach of trust by

Weinstein or Fried in their trading in the Debtor's stock during the proceedings, as a matter of law. Though omitting even to mention the race-track rent diversions (the alternative grounds of the petitions for removal from office and denial of compensation), and refusing to remand, the Court of Appeals likewise found no breach of trust by Weinstein or Fried in their rent diversions (R. 574, 582).

As noted, Wolf had alleged the race-track rent diversions as alternative grounds of both removal from office and denial of compensation. Moreover, Wolf had brought on another petition—returnable concurrently, in January of 1960, with the removal petition—which alleged the same race-track rent diversions, and which sought the Debtor's recovery of those rents and the rejection or cancellation of Fried's race-track lease. The District Judge severed that lease-cancellation petition and adjourned trial thereon *sine die* (R. 249-50, 256). He proceeded to hear evidence on the race-track matter, but only as it related to removal and compensation. In ruling on removal and compensation, on June 14, 1960, and again on November 7, 1960, the District Judge expressly declined to make any findings or conclusions on the race-track matter (R. 498-500, 249-250). In November of 1960, Wolf's lease-cancellation petition finally came on for a ten-day trial (R. 252, 256). On June 28, 1961, the District Judge decided that petition. He ruled that Nazareth Enterprises, Inc., was Fried's *alter ego*, and that they both owed the Debtor back-rents exceeding $22,000; however, he denied recovery of the food-concession rents, and he denied cancellation or rejection of the lease (R. 265-279). That District Court decision of June 28, 1961, was before the Court of Appeals when No. 26362 was argued on August 17, 1961.

On September 12, 1961, the District Judge entered an order on his June 28th race-track decision. Weinstein, Fried and his corporation, and Wolf cross-appealed (No. 27248; *see* 303 F. 2d 152). During the pendency of those appeals (in No. 27248) the Court of Appeals handed down its deci-

sions in No. 26362 and No. 27000, on November 9, 1961, Judge Friendly stated:

> "* * * the court may consider, in an appropriate case, that a purchase or sale of stock by a person not within § 249 requires reduction or even elimination of compensation from an estate under the court's supervision, or removal of such person from office. * * *" (R. 581)

The Court of Appeals granted no such relief, and refused remand, notwithstanding Wolf's petition for rehearing (R. 585). (*See also* 303 F. 2d 152.)

The evidence and findings of particular materiality are as follows:

1. *Fried as "Fiduciary":* The relief sought in No. 26362, both statutory and non-statutory, predicates that Fried, as the Debtor's general manager, is a "fiduciary" of the Debtor, the stockholders, and the Chapter X court. Fried denies such status. No such issue is raised by Weinstein, whose duties and powers, as president and a director, are defined in the Debtor's By-Laws (Saul General: Examiner's Exh. 1; R. 168 [not printed]). However, those By-Laws are silent as to a general manager.

The District Judge has explicitly ruled that both Weinstein and Fried were "fiduciaries" for purposes of Wolf's petitions in No. 26362 (R. 43, 491, 251). Numerous petitions and orders filed during the proceedings, especially those relating to Fried's compensation, describe his duties and powers (R. 9-12, 15, 17, 21-2, 29-30, 34, 38). Interrogated by the District Judge, Fried himself summarized his actual sharing with Weinstein the management of the Debtor's business:

> "The Court: Mr. Fried, how often is Mr. Weinstein at the Market?
>
> "The Witness: At least once a week.

"The Court: In the interim, when he is not at the market, who operates the business, and manages the property of the debtor?

"The Witness: I do, sir." (R. 485-6)

Thereupon, Judge Sugarman stated, on June 14, 1960, in rendering his decision:

"The Court: The only difference between you and Mr. Weinstein is that you [Fried] claim you were a mere menial employee and not a fiduciary, but from my knowledge of this proceeding over the past number of years, my visit to the Market, and so on, you were substantially more than a mere employee. You were no cop in the parking lot. You ran the business while Mr. Weinstein wasn't there. As you admitted, you operated the business and managed the property of the debtor. The fact that you consulted and got approval from the directors does not diminish your status in the structure of the debtor. You were the managing agent." (R. 487)

2. *Trading in Debtor's Stock:* Weinstein and Fried have stipulated that they had purchased stock of the Debtor during the Chapter X proceedings, and subsequent to the entry of orders authorizing the Debtor to pay them compensation for services rendered to the Debtor, and both prior and subsequent to their receipt of such compensation (R. 441-3). The record shows a two-year course of buying and selling by them, for their own accounts and others. *E.g.*:

(a) On May 7, 1957, Weinstein acquired options to purchase Masur's four shares and Treat's two shares, and personally advanced the option price. On June 14, 1957, he personally advanced the balance of the purchase price. Subsequently, he was reimbursed by Mrs. Blanche Waldman, in whose name the purchase was made on June 14th. Mrs. Waldman is Weinstein's sister; it was Weinstein who first advised her to buy the stock; and she relied on him com-

pletely to handle the transaction for her (R. 290-5). Those six shares were originally purchased from Malakoff as 3.0% of the total (200) shares; under the Court of Appeals' decision below, they are equal to 4.11%. Upon interrogation by the Debtor's attorney, Weinstein testified:

> "Q. Mr. Weinstein, you know that as president of the debtor that you are a fiduciary? A. I appreciate that.
>
> "Q. Mr. Weinstein, do you know as president of the debtor and that as a fiduciary you are not supposed to go out on the market and purchase stock of the debtor? A. Yes, sir.
>
> "Q. Yet you purchased this particular stock? A. Not for myself." (R. 295)

(b) On January 7, 1958, Laupheimer purchased one of D. H. Clark's three shares, and thereupon re-sold ⅔ of that one share to Weinstein for his own account (R. 303-4, 463). That one share was originally purchased from Malakoff as 0.33% of the total (200) shares; under the Court of Appeals' decision below, it is equal to 0.46%.

(c) A certain "Agreement of the Stockholders" of the Debtor, dated as of December 1, 1957, and effective for two years thereafter, was drafted by Weinstein and was executed (personally or by representatives) by 14 of the Debtor's 41 stockholders of record, including Weinstein, Laupheimer, and Fried (Saul General: Examiner's Exh. CA; 529, 963-8).

> "1. Each of the parties agrees that upon receipt of a bona fide offer to purchase all or any part of the stock held by them, which is intended to be accepted, and before entering into any contract for the sale thereof, he * * * must *first offer* the same for sale to the remaining parties hereto." (*Id.*, emphasis supplied).

On February 16, 1959, Weinstein asserted the applicability of the agreement to the stock of B. Clark and D. H. Clark.

On March 2 and 3, 1959, Weinstein and Fried purchased the remaining two shares of D. H. Clark's stock, B. Clark's four shares, and Karapontso's two shares. Those eight shares were originally purchased from Malakoff as 4.0% of the total (200) shares; under the decision below, they are equal to 5.48%. The entire transactions were handled by Weinstein, and the down-payments were advanced by Weinstein personally on March 2 and 3; the balance of the purchase price was advanced by Fried on April 10 and 14; and about April 22, Fried reimbursed Weinstein for his March advances. The March contracts of sale, drafted by Weinstein, stated that Weinstein was "acting on behalf of himself, Jerome Fried, H. Lawrence Laupheimer, and possibly probably others"; however, Weinstein later claimed that he had no beneficial interest in the purchase, and was acting as Fried's attorney in fact (470 2, Wolf's 25, R. 570, 10357).

(d) On December 24, 1957, Fried purchased Manoochehrian's twenty shares. On September 11, 1958, Fried re-sold ten of those twenty shares to Manoochehrian, retaining ten shares, reserving an option to re-purchase the other ten shares, and reserving the right to vote all twenty shares (R. 170, 176 7). Those twenty shares were disallowed by the Court of Appeals (R. 596).

3. *Race-track percentage rent reduction:* On August 18, 1952, the Debtor (as Lessor) and Joseph Sherman (as Lessee) entered into a purported ten-year "lease" to the Debtor's race-track, providing for Sherman to promote stock car racing (J. Fried Creditor; Margolis's Exh. C; R. 560, 7413; *See* R. 268). The race-track lease was executed for the Debtor by Fried as general manager. At the time of execution, and thereafter while Sherman was interested in the venture, Fried, Sherman and one Fehr were equal partners in the venture, pursuant to an oral agreement among them (R. 423-4).

On April, 28, 1953, without consideration, Sherman assigned the race-track lease to Nazareth Enterprises, Inc.

("Enterprises"), and Sherman and Fehr relinquished their interest in the race-track venture to Fried (R. 424-6; J. Fried Creditor: Examiner's Exh. 1; R. 556, 8333). Enterprises is a Pennsylvania corporation, of which Fried is president; all its outstanding stock is owned by Fried and his wife, equally. That condition has prevailed "throughout all the time involved here" (*i.e.*, since its incorporation on April 28, 1953) (R. 442). As Fried testified, "Nazareth Enterprises, Incorporated, was myself" (R. 6698). The District Court has ruled that Enterprises is Fried's *alter ego* (R. 272-3, 277).

The race-track lease fixes a percentage rent based on "gross admissions" collected by Enterprises at the box-office on racing days. The percentage rent varies between 12% and 15%, under the lease, depending upon whether the "Lessee" operates the food concession. There is no minimum guaranteed rent (J. Fried Creditor: Examiner's Exh. 1; R. 556, 8333).

Throughout 1953 and part of 1954 (*i.e.*, both before and after the Chapter X proceedings commenced), Enterprises paid rent to the Debtor computed at 12% of gross admissions. Then, sometime in 1954—*during* these proceedings—Weinstein and Fried reduced the percentage rent to 10% of gross admissions at "main events", *provided* Enterprises' aggregate "purses" (prizes paid to winning drivers) exceeded $1,500 per event; *i.e.*, the percentage rent would vary depending upon the amount of Fried's operating expenses.

They never wrote out their agreement. In theory, that agreement has remained expressly tentative from its inception: The percentage-rent reduction would remain in effect only so long as the Debtor profited from the deal; Weinstein—at any time, in his discretion—could restore the strict 12% or 15% rent under the written lease. The reduction has remained in effect continuously since first instituted in 1954. Weinstein and Fried never solicited a bid for the race-track lease from a race-track operator other than Fried (R. 401-4, 411-2, 467; 276-8).

On January 24, 1955—after the rent-reduction agreement—Rosen, as attorney for the Debtor, advised Enterprises (Fried) by letter that the Debtor "opposed" and "rejects" the race-track lease as "burdensome and oppressive" (J. Fried Creditor: Examiner's Exh. K; R. 557). The statute Rosen referred to was §116(1),[13] which authorizes rejection of "burdensome leases and other executory contracts at any time during the proceedings—but which vests authority in the judge, not the trustee (by contrast to ordinary bankruptcy). The Debtor never applied to the Chapter X court for such authority; later, the Debtor opposed Wolf's petition for rejection of the Enterprises lease (R. 273, 276-8).

On January 6, 1958, Enterprises (by Fried, as president) signed a new proposed race-track lease with the Debtor, which provided for a fixed percentage rent of 15% of gross admissions—irrespective of who operated the food concessions, and irrespective of Enterprises' gross "purses" (J. Fried Creditor: Debtor's Exh. AI, ¶3; R. 558, 8656). That lease was not to become effective until approved by the Court; however, the Debtor "agree[d] to apply for such approval without undue delay" (*Id.*, ¶4). No such application for approval has ever been submitted to the Court by Weinstein or Rosen in behalf of the Debtor.

The percentage-rent reduction was first disclosed to the District Court on April 6, 1959, in the course of cross-examination of Fried on his claims as a pre-Chapter X creditor and stockholder. Until then, the reduction had never been disclosed to the Debtor's directors other than Weinstein (R. 404, 270-1).

4. *Race-track food-concession-rent diversion:* From August 18, 1952, when Fried first began to operate the stock-car races at Nazareth (through his partner, Sherman, and then through his corporation, Enterprises), until the present,

[13] Bankruptcy Act, §116(1); 11 U. S. C. §516(1); 52 Stat. 885 (1938).

the food concessions both at the race-track and inside the Market proper have been operated exclusively by one James LaGrotte or by LaGrotte's corporation, J & J Foods, Inc.

Since 1952, LaGrotte and J & J have *always* had written concession agreements or leases with the Debtor with respect to the food concessions *inside the Market*. Three agreements were executed, on January 29, 1952, sometime in 1954 after J & J was organized, and on December 29, 1956. The 1952 and 1954 agreements fixed a percentage rent of 15% against a minimum; they did not specify locations, but they did exclude LaGrotte's operations at the race-track. The 1956 "lease" fixed a variable 15%-10% percentage rent against a minimum; that agreement was altogether silent as to race-track food sales (R. 412-7); Saul General Examiner's Exh. BC, R. 505, 7955; Wolf's 44; R. 571).

Since August of 1952—when LaGrotte began his food-concession operations *at the race-track*—LaGrotte and J & J have *never* had a written agreement with the Debtor or with Fried or Enterprises with respect to the race-track food concession. The oral race-track food-concession agreements between Fried and LaGrotte are understood by both Fried and LaGrotte to be terminable at will by either party. LaGrotte and J & J have always paid "rent" computed at 15% of the food-concession gross receipts (R. 412-7, 467, 477-8).

Throughout 1953 and part of 1954 (*i.e.*, both before and after these proceedings commenced), LaGrotte and J & J paid *all* percentage rents to the Debtor, computed on food sales *both* inside the Market and at the race-track. During that period, Enterprises (Fried) was paying percentage rents to the Debtor computed at 12% gross admissions. Then, sometime in 1954—*during* these proceedings—Fried instructed LaGrotte that J & J was thereafter to pay its rent (15% of its gross receipts) on the race-track food concession to Enterprises (Fried), no longer to the Debtor. LaGrotte complied. He never spoke with Weinstein about the change (R. 405-417, 467, 477-8; 278). LaGrotte testified:

"* * * In other words, when Jerry Fried told me to pay the Market the rent, I paid the Market. When he said to pay him, I paid him. Now what arrangements he made on that, I couldn't tell you." (R. 116)

The race-track food-concession rent diversion was first disclosed to the District Court on April 20, 1959, in the course of cross-examination of Fried on his claims as a pre-Chapter X creditor and stockholder (R. 108-121).

5. *Amount of race-track rent arrangements:* The unauthorized percentage-rent reduction has cost the Debtor at least $18,305.28 through 1960, and $23,996.77 through 1961—*assuming* the District Judge was correct in his ruling that the J & J rents "belonged" to Enterprises, that Enterprises owed only percentage-rent on its gross admissions, and that the race-track lease merely required Enterprises to pay 15% instead of 12% after Fried began collecting the J & J rents in 1957 (R. 276-8, 467-8). But if the Debtor—not Enterprises—"owned" the race-track food concession, then the unauthorized percentage-rent reduction was from 12% to 10% and 7%, and the food-concession rents all "belonged" to the Debtor; then the cost to the Debtor of the unauthorized reduction *and* diversion, is at least $33,706.83 through 1960. (See Appendix A, *infra*.)

6. The modification of the race-track lease by Weinstein and Fried is at least the fourth extraordinary transaction to which they have committed the Debtor during these proceedings without prior authorization by or disclosure to the District Judge. In 1957 and 1958, at their instance, the Debtor contracted to pave the Market's parking lot for over $15,000, the Debtor built an office building annex for Fried for over $6,000, and the Debtor borrowed $30,000 from a non-institutional lender at interest exceeding 6% and secured by an assignment of rents. The District Judge eventually ratified those transactions, after substantial modifications of the contracts (R. 248; *see* 280 F. 2d 891).

Summary of Argument

No. 27000

No. 27000 involves the allowance of claims to *stock interests* in the Debtor, a Pennsylvania corporation undergoing reorganization in the Southern District of New York. An overissue of stock (absolutely void under Pennsylvania law) precipitated this proceeding. The Chapter X court is adjudicating the ownership of a single class of the Debtor's stock, all issued and vested prior to the proceeding. The 36 competing stock-claimants are the real parties in interest; the Debtor is a nominal party. No plan of reorganization is pending, after more than nine years in court. The error below was the application of "federal" or "general" equity instead of applicable Pennsylvania and New York rules of decision to determine stock ownership.

1. *Rules of Decision:* In any federal civil action—a bankruptcy reorganization proceeding included—state law determines whether stock was validly issued by a corporation, and who among competing stock-claimants owns the validly issued stock.

> "§ 1652. The laws of the several states, except where the Constitution or treaties of the United States or Act of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply." [14]

The *Erie* [15] *principle* applies to *nondiversity* actions, too, by Congressional mandate (largely codifying this Court's prior case-law). No matter whether the nomenclature invoked is "law" or "equity," "rights" or "remedies," "substance" or "procedure" or "practice": the test is "outcome-

[14] Rules of Decision Act, 28 U. S. C. § 1652, 62 Stat. 944 (1948).
[15] *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938, *per* BRANDEIS, J.).

determinative." The exception—that no federal law or policy supervene in the case—does not apply here. The bankruptcy scheme of distributing assets of insolvent estates to creditors, is irrelevant. No other federal "substantive" law or policy impinges.

The Second Circuit Court of Appeals disregarded applicable state law, and substituted its own "federal" or "general" equity. The decision forfeited corporate stock for a putative lack of consideration to the issuer—disregarding the exclusive *remedy* under Pennsylvania corporation law. Then, "to do equity" (R. 591, 593), the decision impressed a purchase-money resulting trust—barred by both Pennsylvania and New York trust law. The overissue, *per se*, was not confronted. The decision would never have been made by a Pennsylvania or New York state court.

2. *Overissue Void:* Overissues of corporate stock are absolutely void under Pennsylvania law. That is what No. 27000 is all about—and bankruptcy has nothing to do with it.

Nazareth is authorized to issue a total of 200 shares of stock. Malakoff represented his ownership of a total of 200 shares. But he sold, and he caused Nazareth to issue, 262 shares to the 36 stock-claimants in No. 27000. All 36 have affirmed their stock-purchase contracts with Malakoff: all 36 want shares, not money, from the Debtor. Nazareth suffered no wrong: its net worth was not affected by the overissue, nor by the watering of the outstanding stock: no money judgment was entered against Nazareth. The *wrong* and the *loss* at issue, are Malakoff's independent *dilution* of all the stock-claimants' shares of stock, *i.e.*, his dilution of their proportionate interests in Nazareth net worth. The stock-claimants were injured *directly, not derivatively.* The controversy at bar involves the distribution of their loss *inter se*.

The excess 62 shares *must* be eliminated. The Pennsylvania corporation law on overissue would identify and void

the outstanding Nazareth shares in excess of 200, on some arithmetical or mechanistic or chronological basis. The holders of the void overissue would have no recourse against Malakoff: he had died in 1955, insolvent. Absolutely deprived of shares, they would have no recourse against Nazareth for damages on an estoppel or negligence theory; all 36 knew—had "notice" that—Malakoff (*qua* Nazareth agent) was self-dealing in Nazareth stock. But elimination of the overissued 62 shares would *not* resolve the ownership of the 200 authorized shares among the 36 stock-claimants.

An arithmetical or mechanistic or chronological basis of adjudicating ownership, seemed to the District Court arbitrary and inequitable, and was obviated by two general findings—undisturbed by the Court of Appeals—*viz.*: (a) *Identification* of the overissued shares was *impossible*. (b) *All* 36 stock-claimants were equally victims of Malakoff and *innocent* of participation in his wrongdoing, and lacked actual knowledge of his misconduct. Thereupon, the District Court allowed all 36 stock-claims. But instead of simply reducing the 262 outstanding shares *ratably* to the 200 authorized, the District Court substituted a "money invested" index of participation—its only error, Wolf submits.

Absent liability of any stock-claimant in tort, this proceeding is *not* a suit "by a receiver of an insolvent corporation to compel its *promoters* and their *confederates* to restore illicit gains."[18]

And absent a mechanistic or chronological basis for eliminating the overissue, the only way left to exclude any of the 36 stock-claimants, was to stand all 36 (as Malakoff's assignees) in Malakoff's shoes; then, to void *all* the outstanding Nazareth shares, in order to bring estoppel or good-faith-purchase principles of equity into play; finally, to subject

[18] *Cf. McCandless* v. *Furlaud*, 296 U. S. 140, *at* 149 (1935, *per* CARDOZO, *J.*) (*emphasis supplied*).

(derivatively) some—not all—shares or stock claims to defenses and equities available as against Malakoff. The assignees excluded would be those on "notice" of infirmities, and those whose "antecedent debts" were not "value" in "reliance."

This was the theory advocated by the Debtor and the Weinstein-Fried Group on trial and on appeal—the theory rejected by the District Court and adopted by the Court of Appeals. It required *inter alia* that all 262 outstanding Nazareth shares be voided for lack of consideration to the issuer (the only ground supposedly available), and that no "notice" be imputed to the prevailing stock claimants. If Malakoff individually were selling his own valid shares, antecedent debts would be "value." If Malakoff *qua* Nazareth agent were selling an original issue, the later "investors" would be on "notice" of infirmities. So the theory became a purchase-money resulting trust in the Market (assets), not in Nazareth shares. Now, Malakoff was to be the *prevailing stock-claimants'* agent or trustee in purchasing the Market, not Nazareth shares. Antecedent debts would neither support an estoppel or good-faith purchase, nor constitute advances toward the purchase price of the Market. "Notice," if not absent, would be ignored—an "equity" strange to the jurisprudence. By excluding the aggrieved stock-claimants on that theory, the overissue would vanish. The fundamental problem—the overissue—need never be faced.

3. *Lack of Consideration for Stock:* All 36 stock-claimants paid Malakoff, the seller—not Nazareth, the issuer—for their Nazareth shares. *Therefore*, both Courts below voided *all* shares for lack of consideration.

The Pennsylvania Business Corporation Law provides:

> "§ 610. Validity of Shares.—The fact that shares are issued in violation of, or without full compliance with, the provisions of this act, *shall not make the shares so issued invalid*, unless they are issued in

violation of Article XVI, Section seven, of the Constitution of this Commonwealth." [17]

The Pennsylvania Constitution provides:

> "[XVI] § 7. No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * * " [18]

But the *remedy* is *not* cancellation of stock:

> "* * * However, the Pennsylvania cases are agreed that this constitutional provision [Art. XVI, § 7], standing alone, does not cause the issuance of stock without prepayment to be void. Rather, it is necessary that the legislature shall *implement* the constitutionally stated policy by a statute declaring the nature and extent of any infirmity which attaches to the stock so issued, and *what may be done about it. [Pa. cases cited.]*." [19]

The Court below read the Pennsylvania Constitution *only* (R. 591, n. 2; 593, n. 4); and altogether disregarded the Pennsylvania case-law interpreting it, as well as the Pennsylvania statutes implementing it—a repudiation of the quintessence of *Erie*.

(a) *Remedy:* The Pennsylvania Business Corporation Law has "implemented" the Pennsylvania constitutional policy, in detail. The remedy for lack of consideration to the corporation for stock issued, is *assessment* or call—collectible like any other contract debt, and secured by a lien

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[17] Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P. L. 364, Art. VI, § 610 (1933) (*emphasis supplied*).

[18] Pa. Const., Art. XVI, § 7.

[19] *Grafton* v. *Masteller*, 232 F. 2d 773, *at* 775 (3d Cir., 1956, *per* HASTIE, *J.*); *cert. den.* 352 U. S. 832 (1956) (*Pa. forum; diversity jurisdiction; emphasis supplied*).

on the shares themselves. Cancellation may be effected *only* after foreclosure of the corporate lien on the stock, and then *only* if public sale brings no purchase or if the corporation fails to collect a money judgment for the deficiency.[20] In effect, if a stock subscription is unpaid, a stockholder has a statutory right of *redemption*—an opportunity (valuable in a rising market, as here) to pay the balance owed on his subscription. Management, by a selective call and lawsuit (or appeal), cannot forfeit stock to the issuer (and indirectly to the other stockholders) for lack of *pre*payment. This is "substantive."

(b) *Burden of Proof:* Pennsylvania law imposes on the issuer the burden of proof—including the risk of persuasion—that a stock subscription is unpaid, and how much is owed. This is "substantive." A stock certificate in regular form and registered on the corporate books—as here—establishes the stockholder's case. The Nazareth stock is no-par: the directors fix the price of the shares and the value of property (other than money) taken in consideration of issuance. In *Nazareth*, no proof was made, and no decision was made, as to the subscription price of the shares, nor the value of the Market property received in consideration of the issuance of all the outstanding shares, nor the amounts unpaid on any specific subscriptions. On the contrary, Judge Moore wrote:

> "* * * * From these persons [disallowed] the Debtor did not receive and was not intended to receive anything of value, either from them or *from Malakoff*. These shares as a matter of Pennsylvania law could have had no validity as an original issue. * * *
>
> "Despite the cloud of illegality obscuring *any* stock issuance, the Debtor came into corporate being

[20] Pa. Bus. Corp. L. §§ 604, 605, 609; 15 Purdon's Pa. Stats. Ann. §§ 2852-604, 605, 609; P. L. 364, Art. VI, §§ 604, 605, 609 (1933).

> and did acquire a valuable property which it still holds. *The Market property is sufficient to support a valid stock issue* to those entitled thereto. The sellers (Philadelphia group) have been paid for that property *by Malakoff*. * * *" (R. 591-2; *emphasis supplied.*)

In other words, the Market was paid for by Malakoff, and is sufficient consideration under Pennsylvania law for the issuance of *new* stock for purposes of a plan of reorganization—but the Market is *not* sufficient consideration under Pennsylvania law for the issuance of *old* stock for purposes of the allowance of claims! No reason is given—and there is no reason—why the Market should not have been sufficient in *value* to support a valid stock issue—old or new—to *all* the stock-claimants.

(c) *Res judicata:* The Chapter X summary proceedings afforded the Debtor the same opportunity as a local action to obtain the relief prescribed by Pennsylvania law, *viz.*: assessment, prerequisite to forfeiture. The Debtor could—and did—sue all the stock-claimants (who had appeared generally) for the allegedly unpaid subscription price. The District Court denied the Debtor's claims therefor (R. 264). No appeal was taken from that portion of the judgment by anyone. No stock-claimant owes any amount on a stock subscription: so much is *res judicata*. Under Pennsylvania law, absent liability on a subscription, shares cannot be forfeited to the issuer-corporation. This is "substantive."

4. *Purchase-Money Resulting Trust:* Having cancelled *all* the outstanding Nazareth stock as void for lack of consideration (despite the Pennsylvania corporation law), the Court of Appeals impressed a purchase-money resulting trust. What began as a distribution of the *Debtor's stock* in a reorganization of the Debtor, finished as a distribution of *Malakoff's assets* without Malakoff. Judge Moore wrote:

> "* * * The sellers (Philadelphia group) have been paid for that [Market] property by Malakoff. Malakoff in turn obtained the money *for this purpose* from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a *trustee*, fiduciary, *agent*, promoter or syndicator (the terminology is unimportant—the facts create the rights) *for those who gave him their funds for investment in the project.* They should in equity receive that for which they paid." (R. 592-3; *emphasis supplied.*)

Disallowed were the stock-claims of "those who did not make any payment but who rely upon antecedent indebtedness of Malakoff and other transactions with him unrelated to the Nazareth venture as consideration." (R. 594)

The rules of decision in *equity* in both Pennsylvania and New York bar such a *remedy* as the trust impressed below. This is "substantive."

(a) In *New York*, the purchase-money resulting trust has been abolished altogether, by statute.[21]

(b) In *Pennsylvania*, resulting trusts have been severely curtailed, by statute and case-law. A purchase-money resulting trust could operate here in favor of an "investor" *only* if his advances had been made to Malakoff *before* Malakoff paid the purchase price of the realty to the Philadelphia Group. Malakoff is said to have paid the Philadelphia Group a total of $77,010.84, and to have received a total of $79,025 from "investors," all *before* February 15, 1952 (R. 589). Yet, "investments" aggregating $145,987.34—almost half advanced *after* that date—have been allowed (R. 594-5, 598). Under Pennsylvania law, those later "investors" *cannot* be *cestuis* of a purchase-money resulting trust.

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[21] N. Y. Real Prop. L. (L. 1909, c. 52), (49 McKinney's N. Y. Consol. L.) §§ 91, 94.

(c) Neither can those later "investors" be good-faith purchasers of interests in the Market *vis-à-vis* the true *cestuis.*[22] *Because* Malakoff is now said to have acted (as trustee or *agent*) for *all* the "investors" (not for himself or Nazareth or the sellers) *in their acquisitions* (R. 592-3), the later "investors" are conclusively charged with *notice*—Malakoff's knowledge is imputed to them—that Malakoff was selling them what the true *cestuis* alone owned. Under Pennsylvania law, the stock-claims of the later "investors" with "notice" are entitled to no better standing than the stock-claims which were disallowed because consideration was "antecedent indebtedness of Malakoff." (*See* R. 592, 594.)

(d) If the later "investors" were admitted to participation on a *constructive trust* theory—if Malakoff is supposed to be a trustee *ex malificio* instead of or in addition to a resulting trustee—then those stock-claimants, too, should be admitted whose claims were disallowed because they "rely upon antecedent indebtedness of Malakoff and *other transactions* with him unrelated to the Nazareth venture as consideration" (R. 594). Those "other transactions" likewise raised constructive trusts *vis-à-vis* Malakoff. The Court below has abandoned all semblance of *notice* and *tracing* with respect to the later "investors." Indeed, on a constructive trust theory, Malakoff's creditors and *cestuis at large* should be admitted to participation in the Market.

5. *"Clearly Erroneous" Rule:* Apart from the Rules of Decision Act, the principal federal law applicable to No. 27000 is procedural—Rule 52(a).[23] The foregoing discussion has assumed (*arguendo*) that the Court of Appeals' statement of facts was correct. However, its statement of facts was *not* correct. The major errors (among many) were: (a) *tracing* of the purchase price of the Market, thus

[22] 21 Purdon's Pa. Stats. Ann. § 601; P. L. 425, § 1 (1901).
[23] Rule 52(a), Fed. Rules of Civil Proc., *f.* 28 U. S. C. § 2072.

setting aside the District Court's finding of *no tracing;* and (b) *intention* of the prevailing stock-claimants to deal with Malakoff in a *fiduciary* capacity, thus setting aside the District Court's finding that *all* 36 stock-claimants intended to deal with Malakoff in his *individual* capacity as stockholder-seller. The appellate substitution of findings, of course, was essential to the impression of a purchase-money resulting trust. But the District Court's findings were not "clearly erroneous"; indeed, they were the only reasonable findings on the evidence. In substituting its own findings, the Court of Appeals has committed an egregious violation of Rule 52(a).

6. *The Facts and the "Equities":* The Court below undertook "to do equity" (R. 591). Irrespective of the applicable rules of decision, Wolf would not be aggrieved if the Court had achieved its avowed purpose. The complex facts and the simple equities can be crystallized by focusing on the stock-claims of Weinstein and Fried, the winning appellants in the Court of Appeals. (See R. 120-6, 154-8.)

Weinstein and Fried, like most of the 36 stock-claimants, received Nazareth stock certificates early in 1953, for 7 shares and 3 shares (respectively), issued in each name, dated February 2, 1953, and regular in form (*i.e.*, bearing the corporate seal, and signed by Malakoff, then president, and by Fried, then secretary-treasurer). Fully 18 months earlier, in September of 1951, they had made their stock-purchase contracts with Malakoff, and they had then paid Malakoff—not Nazareth—for their shares, supposedly 3.5% and 1.5% of the total 200 shares. Weinstein paid $7,000 by check to Malakoff. Fried paid $2,000 by "credit" for a "profit" owed him by Malakoff on some "other transactions * * * unrelated to the Nazareth venture" (R. 594); nevertheless, Fried's stock-claim was allowed below. Weinstein and Fried collected "dividends" from Malakoff—not from Nazareth—for more than 18 months, at 20% per year on their "invest-

ments," yielding returns of over 30% before Malakoff failed personally. Fried's stock-purchase contract with Malakoff was oral. The only written contract and "muniment of title" held by Weinstein (and most of the stock-claimants) for 18 months, was Malakoff's personal letter-receipt—drafted by Weinstein, as Malakoff's lawyer—which read:

> "* * * all of the authorized stock of The Nazareth Farmers and Auction Market Inc. [*sic*] which owns the Market has been issued to me. * * * In the course of my management of the Market, I may cause to be issued to you *n* shares of my present stockholdings. * * *" (R. 186-7)

If Weinstein were awarded 3.5% of the total Nazareth stock, he would receive precisely "that for which [he] paid" (R. 593)—as under an express trust or a constructive trust. If he were awarded more, he would receive an unearned windfall, at the expense of other stock-claimants. Yet, more is what he sought on appeal below; and the Court of Appeals awarded him 4.79%, increasing his "shares" of Nazareth by about 37% (apart from the "dividends" he collected from Malakoff). The peculiar trust impressed below is the sole "equitable" device which can penalize 6 stock-claimants, while enriching 30 others, for Malakoff's individual wrongdoing—of which all 36 have been found equally innocent.

7. *Ratable Distribution of Fungible "When-Issued" Shares, by Contract:* The applicable rule of decision here—and the "equitable" resolution of all stock-claims—is § 6 of the Uniform Sales Act, in force in Pennsylvania and New York during the two-year period of the stock-purchase transactions with Malakoff, and *applicable to the sale of "when-issued" stock.* The corporate overissue is no more significant than if Malakoff had purported to sell an aggregate of 262 shares of AT&T while he bought only 200.

"[§ 5] 3. Where the parties purport to effect a *present sale of future goods*, the agreement operates as a contract to sell the goods."

"[§ 6] 1. * * * If the parties intend to effect a present sale [of an undivided share of goods], the *buyer*, by force of the agreement, becomes an *owner in common* with the owner or owners of the remaining shares.

"2. In the case of fungible goods, there may be a sale of an undivided share of a specific mass, *though the seller purports to sell and the buyer to buy a definite number*, * * * of the goods in the mass, and though the number, * * * of the goods in the mass is undetermined. By such a sale the buyer becomes owner in common of such a share of the mass as the number, * * * bought bears to the number, * * * of the mass. * * *"[24]

The *tripartite commercial* relationship among Malakoff, Nazareth, and the 36 stock-claimants *in the sale of Nazareth stock*, governs. Imputed "notice" of Malakoff's wrongdoing, and antecedent debts as "value," are irrelevant. No money judgments are awarded against anyone. The stock-purchase contracts with Malakoff—all affirmed by the parties—determine their proportionate "shares" or "interests" *inter se*. No money or "investment" index is substituted; no new contracts are made by the courts. The loss caused by Malakoff's oversales, is absorbed equally and ratably by all 36 stock-claimants, in proportion to the outstanding shares of Nazareth stock in their hands. These rights are "vested" under Pennsylvania law. They cannot Constitutionally be divested.

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[24] N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) §§ 86(3), 87; 69 Purdon's Pa. Stats. Ann. §§ 61(3), 62, P. L. 543, §§ 5(3), 6 (1915) [*Repealed*]; Uniform Sales Act, §§ 5(3), 6 (*emphasis supplied*).

No. 26362

No. 26362 involves the *denial of compensation* to officers of a Chapter X Debtor in possession, and their *removal from office*, for misconduct *during* the reorganization proceedings, *viz.*: personal trading in the Debtor's stock, and diversions of the Debtor's rents to themselves. The questions presented are the interpretation of § 249 and § 221(4) of Chapter X, and the proper choice of law as to Chapter X fiduciary compensation and continued service.

1. *Statutes*: The relief sought by Wolf, derivatively in favor of the Debtor and against Weinstein and Fried, the Debtor's president and general manager (respectively), is mandated by two sections of Chapter X, enacted in 1938, *viz.*:

> "§ 249. * * * No compensation * * * shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock. * * *." [25]

> "§ 221. The judge shall confirm a plan if satisfied that— * * *
>
> "(4) all payments made or promised by the debtor * * *, for services * * * in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are *reasonable* * * *; * * *." [26]

Section 249 means what it says. Section 221(4) means what this Court said it meant over 20 years ago, in the *Woods* case:

> "Under chap. X of the Chandler Act the bankruptcy court has plenary power to review all fees and

[25] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).
[26] Bankruptcy Act, § 221(4); 11 U. S. C. § 621(4); 52 Stat. 897 (1938) (*emphasis supplied*).

expenses in connection with the reorganization from whatever source they may be payable. [Footnote, quoting § 221(4).] Reasonable compensation may be allowed. * * * Furthermore, *'reasonable compensation for services rendered' necessarily implies loyal and disinterested service* in *the interest of those for whom the claimant purported to act.* * * * It is no answer to say that fraud or unfairness were not shown to have resulted. * * * Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation." [27]

Section 249 is an explicit Congressional mandate to deny compensation from the estate to any Chapter X "fiduciary" who buys or sells the Debtor's shares (or other securities) during the proceedings for his own account. Section 221(4), as interpreted by *Woods*, is a broader mandate to deny compensation to any Chapter X "fiduciary" for misconduct. The misconduct extends to conflicts of interest and breaches of trust including—but not limited to—trading in the Debtor's stock for the fiduciary's own account. *E.g.*, § 221(4) also applies to a fiduciary's trading for the account of another where he thereby acts for fewer than all of his principals or *cestuis*, and to the fiduciary's participation in diversions of estate assets.

Section 221(4) further governs all compensation paid out of the estate indirectly, *e.g.*, fees owed contractually by interested parties to their own representatives for services rendered in the proceedings, though the fees are not disbursed by the trustee.

> "Hence Congress instituted controls, controls which became more pervasive as § 77B was evolved into Chapter X. * * * And § 221(4) is written in per-

[27] *Woods v. City Nat. Bank & Tr. Co.*, 312 U. S. 262, *at* 267-8 (1941, per DOUGLAS, J.) (*emphasis supplied*).

vasive terms—it applies to 'all payments' for services * * *, whoever pays them. * * *"

"These practical considerations support the literal reading of § 221(4) that it is the bankruptcy court that has jurisdiction to pass on these fees. Its jurisdiction is therefore exclusive * * * *"[28]

2. *Rules of Decision*: Congress and this Court deliberately exact a rigorous *federal* standard of conduct of all fiduciaries in federal receivership proceedings.

(a) The federal standard in issue applies to *compensation* and continued service, not necessarily to restitution of diverted estate assets and business opportunities. The difference in result may appear in the same case.[29] The remedies are cumulative, not exclusive, and are not to be elected by the wrongdoers.

(b) The federal standard applies to *conflicts of interest, per se*, without necessarily involving proof of actual injury to any *cestui*.

(c) *Insider trading* in securities is peculiarly a problem of corporate reorganization, and has thus been dealt with specially and expressly by Congress, in § 249. No provision comparable to § 249 appears in the chapters of the Bankruptcy Act relating to liquidation of estates. By contrast, the federal statute prohibiting fiduciary purchase of estate *assets*, applies equally to bankruptcy liquidation and reorganization proceedings.[30]

Denying compensation to Chapter X fiduciaries for insider trading and other misconduct, is a device to assure "loyal and disinterested *service*." It is a means to the an-

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[28] *Leiman* v. *Guttman*, 336 U. S. 1, *at* 7-8, 9 (1949, *per* DOUGLAS, *J.*).

[29] *E.g., Crites, Inc.* v. *Prudential Ins. Co.*, 322 U. S. 422 (1944, *per* MURPHY, *J.*).

[30] 18 U. S. C. [Criminal Code] § 154; 62 Stat. 690 (1948).

nounced end and purpose of safeguarding assets in federal judicial custody and protecting interested parties from subtle insider looting difficult to prove in fact and not cured simply by more lawsuits for restitution and damages. The federal standard is simply stricter than the standard under "general equity," *because* reorganization is not the usual method of doing business. State standards applicable to private corporations outside receivership, and applicable to "persons who, despite their fiduciary obligations, had been free to buy or sell stock of the corporation before the Chapter X proceeding was contemplated" (R. 580), are a fiction, not a norm, in Chapter X proceedings.

3. *Format and Construction:* Before and throughout these reorganization proceedings, Weinstein has been president and a director of the Debtor, and Fried has been general manager. The District Court appointed no trustee, but continued the Debtor in possession under former management. Weinstein and Fried have been *de facto* co-trustees. The District Court found that both were "fiduciaries" under § 249 (R. 251). Fried questions that finding; the Court of Appeals did not reach the question.

If Weinstein and Fried had applied for compensation *in gross at the winding-up*, under § 247[32] (as do most other "fiduciaries"), then § 249 would apply and would bar all compensation to them. So much the Court of Appeals concedes. But Weinstein and Fried have been paid salaries *week-by-week during* the proceedings, under § 191.[33] Section 191 is located in Article VIII of Chapter X, while § 247 and § 249 are located in Article XIII. *Therefore*, said Judge Friendly:

> "* * * Not being required to seek compensation under § 247, they have not been subjected to § 249, and the

[32] Bankruptcy Act, § 247; 11 U. S. C. § 647; 52 Stat. 901 (1938).
[33] Bankruptcy Act, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938).

order of removal cannot survive the fall of its underpinning. [Footnote 5]" (R. 579)

And § 249 does not mean what it says, because its "context" must be restricted (R. 579). (Section 221 is in Article XI. The opinion below cites neither § 221 nor *Woods*.)

That construction of the format of Chapter X disregards (*inter alia*) an explicit statutory command:

"[5]b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate." [34]

4. *Double Standard:* To bolster its statutory construction and application of § 249, the Court below posited a double standard which Congress had supposedly intended and implemented.

"* * * For these strangers [§ 247 applicants] the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from *consensual arrangements*, subject only, in the case of officers, to judicial approval under § 191. * * *" (R. 580; *emphasis supplied.*)

"* * * Chapter X clearly distinguishes between *what is demanded* of a trustee and *what is expected* of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional trustee * * *) must be *'disinterested,'* * * *. No such requirement was or practically could be imposed on officers of the debtor; * * *." (R. 580-1; *emphasis supplied*).

[34] Amendatory Act, § 5b; Additional Provisions of Act of June 22, 1938 (Chandler Act, c. 575, 52 Stat. 840 *et seq.*), § 5b; 11 U. S. C. § 1, notes.

That decision and reasoning would confound the announced federal policy, and would cloud a hitherto clear *caveat* to insiders.

Under Chapter X, *only* the trustee, the trustee's attorney, and the examiner are required to be "disinterested." It is not alone the officers and employees of a debtor in possession who need *not* be "disinterested." Likewise, virtually every other person serving in the proceedings, and looking to the estate for compensation, need *not* be "disinterested": *e.g.*, the "additional trustee," attorneys employed on specific retainers, indenture trustees, committee members. Except the trustee, the additional trustee, the trustee's attorney, and the examiner, all those persons are appointed by "consensual arrangements" with their clients.

(a) *Function and Power:* The Bankruptcy Act and the equity courts define the responsibilities of Chapter X fiduciaries by their functions, their powers, and their acts—not by their titles. Key operating personnel are "fiduciaries" subject to § 249 and § 221(4) *because* they have access to confidential information, and *because* they have actual control of the debtor being reorganized. Congress used the words "fiduciary" and "representative"—not "trustee"—in § 249 advisedly. Substance, not form, governs.

(b) "*Disinterested*": The word "disinterested" has two meanings—not one—in Chapter X proceedings. The requirement that a trustee (*e.g.*) be "disinterested" under § 156 and § 158[35] as a condition precedent to his *appointment*, relates to a *status* at *commencement* of the proceedings; his peculiar *duties* bar conflicts of interest with any of the interested parties, all of whom he serves equally. The requirement of § 221(4) and *Woods*—" 'reasonable compensation for services rendered' necessarily implies loyal and *disinterested service* in the interest of those for whom the claimant purported to act"—relates to *conduct during* the proceedings

[35] Bankruptcy Act, §§ 156, 158; 11 U. S. C. §§ 556, 558; 52 Stat. 888 (1938).

by any fiduciary, whether he serves one, several, or all. The privilege to serve without *being* "disinterested" under § 158, does *not* license the fiduciary to *act* other than "disinterestedly" under § 221(4) and *Woods*.

(c) *"Consensual Arrangements":* No matter whether the Chapter X court acts on its own motion or on the motion of a party: By statute (§ 221(4), § 249 and other sections) the court has plenary and exclusive control of *all* appointments and *all* compensation. Indeed, under § 221(4), the court *must* review the "reasonableness" of all compensation, irrespective of "consensual arrangements." Under the double standard posited below, "reasonableness" of compensation no longer "necessarily implies loyal and disinterested service." Absent application of the *substance* of § 221(4) (as stated in *Woods*), the exclusive jurisdiction of the Chapter X court over compensation (conferred by § 221[4]) would be hollow.

6. *Race-track rent diversions:* The Weinstein-Fried diversions of race-track rents from the Debtor to Fried *during* the proceedings, were recited in Wolf's petitions as alternative grounds for denial of compensation and removal from office (R. 217-224, 255). Both Courts below made their respective decisions in No. 26362 on the stock-trading and § 249 alone. Yet, Judge Friendly wrote:

> "* * * Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees [Wolf] complain; * * *." (R. 582)

The implicit condonation of the rent diversions, without findings or conclusions by either Court below, should not stand. If the stock-trading does not suffice for the relief sought by Wolf, then the race-track rent diversions must be decided under § 221(4).

7. *Restitution of Past Compensation:* The denial of compensation under § 249 and § 221(4), applies to fiduciary

service throughout the Chapter X proceedings. The entire expectancy is defeated if the fiduciary applies for compensation in gross at the winding-up. The same result should obtain here. To obey the statute, and to achieve the end contemplated, Weinstein and Fried should restore to the estate the salaries they have heretofore received during the Chapter X proceedings.

8. *Removal from Office:* Statutory denial of compensation was intended to assure "loyal and disinterested *service*" by fiduciaries *during* the proceedings. To achieve that end, Weinstein and Fried should be removed from office, and barred from further service during these proceedings, as the Debtor's managers. The *propriety* follows from § 249, § 221(4), and *Woods*.

The District Court's conclusion that the Chapter X court lacks *power* to *formally* remove officers of a Debtor in possession, is erroneous. (The Court of Appeals never reached the question.) Chapter X gives the judge plenary control of the Debtor; and it vests the judge with the powers of an equity receivership court. The Pennsylvania Business Corporation Law expressly vests local courts of equity with power of removal for cause. To continue the Debtor in possession as a *quasi*-trustee, provision must be made for removal from office for cause, no less than for election to office.

* * *

In No. 27000, the Court below applied federal rules of decision to a state question—the allowance of claims to stock interests which had vested under state law prior to reorganization. In No. 26362, the Court below applied state rules of decision to a federal question—the administration during reorganization of an estate in the custody of a federal court. In both cases, the Court below opted, in effect, to apply *No Law*, and instead to exercise naked power based on subjective notions of "general equity."

No. 27000

State law, not federal law, should determine the allowance of claims to stock interests in the Debtor in bankruptcy reorganization. Under applicable state law, all 36 stock-claims here should be allowed in direct proportion to the 262 outstanding shares of stock of record, notwithstanding the overissue.

The principal questions before the Court in No. 27000 are the proper choice of law as to the allowance and disallowance of claims to stock interests in a debtor in reorganization under Chapter X of the Bankruptcy Act, and the interpretation of the Rules of Decision Act [36] in a nondiversity case.

The applicability of state rules of decision in bankruptcy reorganization proceedings and other federal *nondiversity* cases, presents a question of federal law which has been noted by this Court repeatedly since *Erie* [37] in 1938, but which has not yet been settled. Further, if state rules of decision are applicable, the questions are presented, Whether the application of such state rules of decision extends to cases in equity as well as at law, and to remedies as well as rights—questions likewise noted but unsettled.[38] Still another question which this Court has expressly left unsettled at least four times [39]

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[36] Rules of Decision Act, 28 U. S. C. § 1652, 62 Stat. 944 (1948).

[37] *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938, *per* BRANDEIS, J.).

[38] *See Russell* v. *Todd*, 309 U. S. 280, *at* 294 (1940, *per* STONE, J.) (*nondiversity*); *Guaranty Trust Co.* v. *York*, 326 U. S. 99, *at* 99-101 (1945, *per* FRANKFURTER, J.) (*diversity*); *Holmberg* v. *Armbrecht*, 327 U. S. 393 (1946, *per* FRANKFURTER, J.) (*nondiversity*); *Textile Workers Union* v. *Lincoln Mills*, 353 U. S. 448 (1957, *per* BLACK, J.) (*W. B.* 353 U. S. *at* 474, 482-3, *per* FRANKFURTER, J., *dissenting*) (*nondiversity*).

[39] *D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447, *at* 456 (1942, *per* DOUGLAS, J.; FRANKFURTER, JACKSON, JJ., *concurring*); *McKenzie* v. *Irving Trust Co.*, 323 U. S. 365, *at* 371, n. 2 (1945, *per* STONE, C. J.); *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, *at* 162 (1946, *per* BLACK, J.; FRANKFURTER, J., *concurring*); *Richards* v. *U. S.*, 369 U. S. 1, *at* 7, n. 13 (1962, *per* WARREN, C. J.).

since *Erie*, may be presented here, *viz.*: the choice of conflicting state laws by a federal court in a nondiversity case; *i.e.*, here, if state law applies with respect to corporations and trusts, must the bankruptcy court adopt the choice-of-law rules of the forum state (New York)? If not, must the bankruptcy court adopt the "whole law" or only the "internal law" of the state to which it looks for decision (New York or Pennsylvania)?

Both Courts below ignored the applicable state law, and the question of its applicability. Their decisions represent their respective conceptions of "general" or "federal" equity, and differ markedly from both New York and Pennsylvania rules of decision.

As to the substantive issues underlying the choice-of-law questions:

No court can fully satisfy all 36 stock-claims interposed in No. 27000. There is not enough Nazareth stock. Each share outstanding purports to be $\frac{1}{200}$ of the total, under the Nazareth articles of incorporation; and so Malakoff promised and represented to his customers. But Malakoff sold at least 262 shares to the 36 stock-claimants in No. 27000; he caused an overissue of at least 62 shares by Nazareth. What Nazareth received for all 262 shares, was the Market (realty and business). The Debtor and the Weinstein-Fried Group contend that the Market was not sufficient consideration for the authorized 200 shares—indeed, that the Market was consideration for no shares at all.

Whether by overissuance or by issuance without consideration (or both), Malakoff did commit a wrong and impose a loss. In the first instance, that loss did not fall on the corporation or its stockholders *derivatively*. What Malakoff did, was to over-divide and *dilute* the proportionate interests of the 36 stock-claimants in the Market and the Nazareth corporation. In the first instance, the wrong and the loss

were suffered by all the stockholders *directly* in proportion to their stockholdings of record—all 36 of them alike victims and innocent of wrongdoing. The major substantive question is how to distribute that loss among the 36 stock-claimants.

A most elementary proposition underlies Wolf's position in No. 27000: A corporation, after all, is simply an association of persons who have elected—by contract—to use a particular legal form or device—the corporation—to hold property and to conduct a business together. At least to the extent that their express contracts do not resolve controversies among themselves, they are subject to the law of corporations of the appropriate jurisdiction to resolve their controversies for them. The stockholders cannot at once adopt and repudiate the corporate form; they cannot pick and choose among corporate and non-corporate laws. The joint-venture form does not apply—

> "... a joint venture may not be carried on by individuals *through* a corporate form. [Cases cited.] The two forms of business are mutually exclusive, each governed by a separate body of law. When parties adopt the corporate form, with the corporate shield extended over them to protect them against personal liability, they cease to be partners and have only the rights, duties and obligations of stockholders. They cannot be partners *inter sese* and a corporation to the rest of the world.' [Citation.]" [40]

—nor do other non-corporate forms of doing business and holding property apply, *e.g.*, the resulting trust.[41] Before the chancellor invokes a supervening "equity" to determine the rights of competing stock-claimants, he owes respect to

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[40] *Weisman* v. *Azenair Corp.*, 3 N. Y. 2d 444, *at* 449, 165 N. Y. S. 2d 745 (1957, *per* CONWAY, C. J.) (*emphasis in original*).

[41] *See Musselman* v. *Myers*, 240 Pa. 5, 87 A. 425 (1913, *p.c.*).

the corporate law and policy of the appropriate jurisdiction, especially in our federal system. The rules of decision of Pennsylvania and New York already embody an "equity" deliberate, ample, and harmonious.

The substantive relief sought here by Wolf, as against the Debtor (nominally) and all other stockholders in interest, is the allowance of all 36 stock-claims involved in No. 27000, in such amounts that the Debtor's 200 authorized shares will be distributed among those 36 stockholders of record, in direct proportion to their respective record holdings of the 262 shares actually issued to them in 1953. There would be no judgment for money damages against the Debtor, and no judgment for assessment of stock subscription prices against the stockholders. The massive record compiled by the District Court in these proceedings, and the District Court's findings and conclusions, suffice for—and compel—such final decision here.[42]

[42] No. 27000 involves 36 stock-claimants and 262 shares of record. It does not involve the five stock-claimants in the "Margolis Group," whose claims to 54 shares were tried separately by Referee Joyce, were never tried or decided by Judge Sugarman on review, and were decided by the Court of Appeals, in No. 26962, at the same time as No. 27000, but without joinder of the 36 stock-claimants (including Wolf) involved in No. 27000. In an abundance of caution, Wolf has named and saved the Margolis Group as respondents on this appeal from No. 27000. Nevertheless, Wolf seeks no relief with respect to the Margolis Group's 54 shares. Wolf submits that no decision of the Margolis Group stock-claims is proper in the absence of the record in No. 26862, and that this Court's award of the relief prayed for by Wolf in No. 27000 would require a reservation and remand to the District Court to determine whether and to what extent the Margolis Group were entitled to participate in the 200 authorized shares with the 36 stock-claimants in No. 27000. Such reservation for adjustment had been provided for by the District Court (R. 264, 212), but was superseded by the Court of Appeals (R. 597).

A. Under federal statutes, rules, orders, and decisions of this Court, state—not federal—rules of decision are applicable and determinative in the allowance of claims to stock interests in the Debtor undergoing bankruptcy reorganization.

No. 27000 is a nondiversity case, with federal question jurisdiction "arising under" the Constitutional bankruptcy clause and resting on Chapter X of the Bankruptcy Act. It is mere *form*, and the fortuity of one party's insolvency, that all parties plead by proofs of claim and objections, that they litigate in summary proceedings in bankruptcy, that the federal court decrees allowance or disallowance of claims. The substance is federal adjudication of rights and liabilities. Wolf submits that the *Erie* interpretation and application of the Rules of Decision Act in diversity cases—the *Erie principle*—extends to nondiversity cases as well, this case included.

The threshold question is always the choice of law. The peculiar problem of the federal forum, irrespective of its source of jurisdiction, is whether to resolve a controversy between *private* litigants any differently from the resolution the federal court must *hypothesize* as emanating from a state court in an identical case. The decision below, based on "general equity," conflicts with the rules of decision of both Pennsylvania and New York, the two states having "contact" with the transactions involved. Wolf submits that a state court (or a federal diversity court), sitting in either state, would never have made the decision made by the Second Circuit Court of Appeals in No. 27000, and that, *therefore*, the decision below should be reversed.

1. *The Rules of Decision Act and the* Erie *principle apply to nondiversity cases, bankruptcy proceedings included, and extend to both rights and remedies, in equity as well as at law.*

(a) The Rules of Decision Act expressly applies to all "civil actions," not alone to "trials at common law." The

applicability of state rules of decision does *not* depend on whether a cause of action or a defense sounds "at law" or "in equity."

> "§ 1652. *State laws as rules of decision.*
>
> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in *civil actions* in the courts of the United States, in cases where they apply." [43]

The Reviser's Note to § 1652 states:

> "'Civil actions' was substituted for 'trials at common law' to clarify the meaning of the Rules of Decision Act in the light of the Federal Rules of Civil Procedure. Such Act has been held to apply to suits in equity."

The Reviser's Note (*id.*) refers to the *Mason* case:

> "It was urged upon the argument that § 721 * * *, which provides that the laws of the several states shall be regarded as rules of decision in trials *at common law* in the courts of the United States, by implication, excludes such laws as rules of decision in equity suits. The statute, however, is merely declarative of the rule which would exist in the absence of the statute. * * *" [44]

The relevant Federal Rules of Civil Procedure (referred to in the Reviser's Note to § 1652) are Rules 1 and 2: [45]

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[43] Rules of Decision Act, 28 U. S. C. § 1652, 62 Stat. 944 (1948), amending Judiciary Act of 1789, § 34; 1 Stat. 92, Rev. Stat. § 721, 28 U. S. C. (1940 ed.) § 725.

[44] *Mason* v. *U. S.*, 260 U. S. 545, *at* 558-9 (1923, *per* SUTHERLAND, J.; *emphasis in original*).

[45] Rules 1, 2, Fed. Rules of Civ. Proc., *post*, 28 U. S. C. § 2072.

"Rule 1. *Scope of Rules.* These rules govern the procedure in the United States district courts in all suits *of a civil nature* whether cognizable as cases at law or in equity, with the exceptions stated in Rule 81. * * *"

"Rule 2. *One Form of Action.* There shall be one form of action to be known as 'civil action'."

The *Erie* case was a diversity tort action at law. The *Erie* principle was soon—and steadfastly—applied to diversity suits in equity, of all types.[46]

(b) The applicable state rules of decision extend to *remedies* and *defenses* as well as rights, in equity as well as at law. A right without a remedy is no right. Conversely, there is no remedy except as founded on a substantial and *cognizable* right.[47] The restrictions of the remedy are definitive of the right, and, if statg-created, govern a federal court's adjudication no less than a state court's. Once federal jurisdiction attaches, whether diversity or nondiversity, the federal court can—and should—adapt its processes to afford or approximate the remedy prescribed by the applicable state law. But if state law would withhold a remedy, so, too, should a federal court applying that state law. "It seems to us unjust to allow a plaintiff to come here absolutely depending on the foreign law for the foundation of his case, and yet to deny to the defendant the benefit of whatever limitations on his liability that law would impose."[48] The "outcome-determinative" index of *York* governs what survives of the "equitable remedial rights doc-

[46] *Ruhlin* v. *N. Y. Life Ins. Co.*, 304 U. S. 202 (1938, *per* REED, *J.*); *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945, *per* FRANKFURTER, *J.*).

[47] *Kelleam* v. *Maryland Cas. Co.*, 312 U. S. 377 (1941, *per* DOUGLAS, *J.*).

[48] *Slater* v. *Mexican Nat. R. Co.*, 194 U. S. 120, *at* 126 (1904, *per* HOLMES, *J.*).

trine." Practice alone remains federal in federal application of state law.[49]

These same principles obtain in nondiversity cases, and were applied by this Court even before *Erie*.[50]

(c) Litigations in bankruptcy proceedings—one species of cases in federal courts having nondiversity jurisdiction—are "civil actions" within the comprehension of the Rules of Decision Act.

> "Rule 81. *Applicability in General.*
>
> "(a) * * * (1) These rules * * * do not apply to proceedings in bankruptcy * * *, except in so far as they may be made applicable thereto by rules promulgated by the Supreme Court of the United States. * * *"[51]

The Federal Rules of Civil Procedure have generally been made applicable to bankruptcy proceedings by rules—General Orders—promulgated by this Court, and having the force of law.[52]

> "37.—*General Provisions.* In proceedings under the [Bankruptcy] Act the Rules of Civil Procedure for the United States District Court shall, in so far as they are not inconsistent with the Act or with these general orders, be followed as nearly as may be. * * *"

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[49] *See Levinson* v. *Deupree*, 345 U. S. 648 (1953), *per* FRANKFURTER, J.); 2 *Moore's Fed. Prac.* (2 ed., 1961) ¶ 2.09.

[50] *Mason* v. *U. S.*, *supra*, n. 44, 260 U. S. *at* 559-560; *see Bank of Hamilton* v. *Lessee of Dudley*, 2 Pet. (27 U. S.) 492, *at* 526 (1829, *per* MARSHALL, C. J.); *Mfrs. Fin. Co.* v. *McKey*, 294 U. S. 442 (1935, *per* SUTHERLAND, J.).

[51] Rule 81 (a) (1), Fed. Rules of Civ. Proc., *f.* 28 U. S. C. § 2072.

[52] General Order 37, General Orders and Forms in Bankruptcy, *pursuant to and f.* Bankruptcy Act, § 30, 11 U. S. C. § 53, 30 Stat. 554 (1898), 52 Stat. 855 (1938); 305 U. S. 681 (1939). G. O. 37 applies to proceedings under Chapter X. G. O. 52 (1), (2). *See Orcutt* v. *Green*, 204 U. S. 96 (1907, *per* PECKHAM, J.).

The Chapter X court is expressly vested with the powers of an equity receivership court, in addition to the statutory powers more narrowly relating to administration of the Act. Its jurisdiction and powers are sufficiently broad to approximate the relief available to a private party litigant in a state court of law or equity.[53]

(d) Apart from federal statutes and rules—*i.e.*, even if there were no Rules of Decision Act on the books—the *principle* of *Erie*, irrespective of jurisdictional grounds, requires that the plaintiff's asserted right to relief be founded on some positive political *authority*, state or federal. The federal courts have Constitutional limitations, not only as to cases they may entertain, but as to rights they may enforce and as to defenses they may sustain in cases where jurisdiction has already attached validly. This is not just a matter of Congressional *intent* as expressed in the Rules of Decision Act. This is a matter of Congressional and judicial *power* under the Constitution.

Erie determined the rules of decision in federal *diversity* cases. Narrowly, *Erie* held that the accident of diverse state citizenship between the parties should not bring a result in federal litigation different from the result in an identical litigation in a state court between citizens of the same state; that the federal courts should not be misused, through diversity jurisdiction, for forum-shopping to obtain different results irrelevant to the Constitutional purpose of impartial trial. More broadly, *Erie* also held that judge-made law is state law, too; that Justice Story's desideratum of national uniformity of then-uncodified law-merchant through intercession of the federal courts, had failed of achievement in practice; that the desideratum must yield to a policy of uniformity of state law, in order that federal and state courts sitting within a single state should not pronounce and apply

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[53] Bankruptcy Act, § 115; 11 U. S. C. § 515; 52 Stat. 884 (1938). *See* Hill, *Erie Doctrine in Bankruptcy*, 66 Harv. L. Rev. 1013 (1953); 4 *Collier on Bankruptcy* (14th ed.) ¶¶ 70.04, 70.15[2], 70.25[2], 70.49, 70.70[2], 70.78.

different rules of decision in identical cases. Still broader was the explicit foundation of *Erie*—which has equal application to both diversity and nondiversity cases:

> "*Third.* Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state. And whether the law of the state shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern. There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a state whether they be local in their nature or 'general,' be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts. * * * *"*
>
> "The fallacy underlying the rule declared in Swift v. Tyson is made clear by Mr. Justice Holmes. [Footnote citations.] * * *
>
> "'But law in the sense in which courts speak of it today does not exist without some definite authority behind it.' * * *
>
> "'The authority and only authority is the State, and if that be so, the voice adopted by the State as its own [whether it be of its Legislature or of its Supreme Court] should utter the last word.'
>
> "Thus the doctrine of Swift v. Tyson is, as Mr. Justice Holmes said, 'an unconstitutional assumption of powers by the Courts of the United States which no lapse of time or respectable array of opinion should make us hesitate to correct.' * * * *"* [54]

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[54] *Erie R. Co. v. Tompkins*, 304 U. S. 64, *at* 78-9 (1938, *per* BRANDEIS, J.), *citing and quoting* HOLMES, J., *dissenting*, *Kuhn v. Fairmont Coal Co.*, 215 U. S. 349, *at* 370-2 (1910); *Black & White Taxicab Co. v. Brown & Yellow Taxicab Co.*, 276 U. S. 518, *at* 532-6 (1928).

That foundation has been explained repeatedly since *Erie*, and has been applied and adapted in equity cases involving remedies and defenses, *e.g.*, in *York*:

> "Our starting point must be the *policy of federal jurisdiction* which [*Erie*] embodies. In overruling Swift v. Tyson, 16 Pet. 1; [*Erie*] did not merely overrule a venerable case. It overruled a *particular way of looking at law* which dominated the judicial process long after its inadequacies had been laid bare. [Citations.] Law was conceived as a 'brooding omnipresence' of Reason, of which decisions were merely evidence and not themselves the controlling formulations. Accordingly, federal courts deemed themselves free to ascertain what Reason, and therefore Law, required wholly independent of authoritatively declared State law, even in cases where a legal right as the basis for relief was created by State authority and could not be created by federal authority and the case got into a federal court merely because it was 'between Citizens of different States' under Art. III, § 2 of the Constitution of the United States."
>
> "• • • In essence, the intent of that decision was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the *outcome of the litigation* in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court. • • • "[55]

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[55] *Guaranty Trust Co.* v. *York*, 326 U. S. 99, *at* 101-2, 109 (1945, *per* FRANKFURTER, *J.*) (*emphasis supplied*).

2. *This case involves the validity of stock in the Debtor, and the ownership of stock by the stock-claimants. Notwithstanding the form of adjudication by allowance of claims in bankruptcy reorganization proceedings, the substantive rights of the parties are determined by state law.*

(a) The Court below erroneously viewed the "basic issue" or "problem" in No. 27000 as the formulation of a plan of reorganization, not as the allowance of claims to stock interests:

> "* * * To achieve a reorganization of the Debtor which, insofar as stock issuance and ownership are concerned, never had been properly organized, the trial court had to determine as a *basic issue*: who, if any, were entitled to participate in the stock of the reorganized Debtor. * * *" (R. 590; *emphasis supplied.*)

> "Since the *problem* for the reorganization court is to decide upon the capitalization necessary to do *equity* in the light of the various claims before it, this court need pass *only* upon the immediate *question* of *who should be stockholders of the reorganized debtor* and in what proportions. With these basic principles determined, the solution becomes more clearly defined. * * *" (R. 591; *emphasis supplied.*)

The Chapter X court cannot reach the question, Who *shall be* the stockholders of the reorganized debtor at the close of the proceedings?, until it first decides the question, Who *were* the stockholders of the Debtor at the commencement of the proceedings? Every reorganization involves at least two distinct steps, or stages: *first* determination of its creditors and stockholders, by the *allowance of claims;* and *thereafter*, provision for participation of those creditors and stockholders in the debtor's assets, by formulation of a *plan of reorganization.*[56] The first stage—the allowance of claims—is the only stage this proceeding has reached. No plan of

[56] *See* 6 *Collier on Bankruptcy* ¶ 9.02[1].

reorganization submitted by anyone is even pending before any court in these proceedings; and no issuance of stock in a "reorganized" debtor is properly before the courts.

(b) The allowance of claims of creditors and stockholders in bankruptcy proceedings is normally governed by state law.

> "A purpose of bankruptcy is so to administer an estate as to bring about a ratable distribution of assets among the bankrupt's creditors. What claims of creditors are valid and subsisting obligations against the bankrupt at the time of petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law. * * * "
>
> "* * * We do not reach considerations of policy in bankruptcy administration until there are rights created by applicable local law, to be recognized." [57]

(c) There is no "overruling federal law" or supervening bankruptcy policy applicable in No. 27000: No substantive or positive provision of the Bankruptcy Act or any other federal statute has been invoked or would be applicable here; the rights were not federally created, and this case is no occasion to "legislate interstitially" or to "fashion federal law" as to rights or remedies.[58] The bankruptcy scheme of distribution is irrelevant to a distribution among a single class of stockholders.[59] No federal agency is a party.[60]

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[57] *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156 (1946), *at* 161 (*per* BLACK, J.); *at* 171 (FRANKFURTER, J., *concurring*).

[58] *Cf. McKenzie* v. *Irving Trust Co.*, 323 U. S. 365 (1945, *per* STONE, C. J.); *Holmberg* v. *Armbrecht*, 327 U. S. 393 (1946, *per* FRANKFURTER, J.); *Schwabacher* v. *U. S.*, 334 U. S. 182 (1948, *per* JACKSON, J.).

[59] *See Prudence Realization Corp.* v. *Geist*, 316 U. S. 89 (1942, *per* STONE, C. J.).

[60] *See Bank of America Nat. Tr. & Sav. Assn.* v. *Parnell*, 352 U. S. 29 (1956, *per* FRANKFURTER, J.); *D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447 (1942, *per* DOUGLAS, J.).

This is *not* a suit "by a receiver of an insolvent corporation to compel its *promoters* and their *confederates* to restore illicit gains."[61] Malakoff was the "sole actor," and is not a party. No "inequitable *conduct*" or fraud by *any* of the stock-claimants has been found by the Court of Appeals or the District Court—nor is that the basis for the disallowances below.[62]

(d) The "substantive" rights and defenses involved in No. 27000 were all created by state law.

(i) The controversies between the Debtor and each of the 36 stock-claimants, involve the *validity of corporate stock* challenged on grounds of overissue and lack of consideration for issuance, and the liability of each stock-claimant to the Debtor for an allegedly *unpaid stock subscription*. The Debtor, by its counterclaims, effectually instituted suit as plaintiff to collect those contractual subscriptions for a solvent corporation, and indirectly for its stockholders—*not* to assess its stockholders for contributions to a trust fund for creditors of an insolvent corporation. In voiding and forfeiting corporate stock, the Court below failed to sustain certain defenses asserted by Wolf and created by state (domiciliary) corporation law. No federal law impinges.

(ii) The controversy among the stock-claimants *inter se* involves their proportionate ownership of corporate stock, however many shares were validly issued. Here, the 36 stock-claimants are all plaintiffs (so to speak) competing for allowances in a limited pool of corporate stock; the Debtor is a nominal party. Wolf submits that the commercial *law* of sales resolves that controversy, without recourse to "equity." The Court below, by voiding all outstanding Nazareth stock, treated the Debtor as a corpora-

[61] *Cf. McCandless* v. *Furland*, 296 U. S. 140, *at* 149 (1935, *per* CARDOZO, *J.*) (*emphasis supplied*).

[62] *Cf. Taylor* v. *Standard Gas & Electric Co.* ["*Deep Rock*"], 306 U. S. 307 (1939, *per* ROBERTS, *J.*); *Pepper* v. *Litton*, 308 U. S. 295 (1939, *per* DOUGLAS, *J.*).

tion without stockholders; then, turning from law to equity, the Court below treated the Debtor as a passive or dry trustee holding title to the Debtor's *assets* (the Market) for the benefit of *some* of the 36 stock-claimants *qua cestuis*. The Court of Appeals' decree is a judicial conveyance of Pennsylvania realty, as if these proceedings were a quiet-title action. Its decree is incompatible with the rules of decision in equity in both Pennsylvania and New York as to the relative equities of competing purchasers or *cestuis*. Its decree grants an *affirmative* "equitable remedy" under a "federal general common law" or "federal general equity." No positive federal law gives any party a right in support of that remedy. No federal law or policy even impinges. Applicable state rules of decision bar that remedy.

3. *In this case, no material conflict of laws should be encountered in applying state rules of decision. If conflict should appear, the federal court with nondiversity jurisdiction should use a "grouping of significant contacts" or "center of gravity" rule to choose applicable state rules of decision, and should apply the "whole law" so chosen.*

The only two states with any "contact" with the transactions in issue, are Pennsylvania and New York. Provided the "whole law"—not merely the "internal law"—is applied, no conflict of laws should be encountered. For both states have approached a uniformity of commercial law through the enactment of uniform statutes and by the adoption of similar conflict-of-laws rules.

(a) The "whole law" of the corporation's domicile—here, Pennsylvania—governs the validity of stock, the ownership of stock by stockholders, and the liability of stockholders to assessment or call on a stock subscription or otherwise.[63] The domiciliary state's control of its corporate creatures is as much its own interest as is the situs state's control of

[63] *Harrigan* v. *Bergdoll*, 270 U. S. 560 (1926, *per* BRANDEIS, *J.*), *affg.* 281 Pa. 186, 126 A. 269 (1926, *per* FRAZER, *J.*). *See* 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 8-106; P. L. 3 (1953), *added* P. L. 1023 (1959) § 8.

realty within its borders. This Court's recognition of that interest has dictated that other states apply domiciliary law, within the full-faith-and-credit provision, in adjudicating the relationships between the corporation and its stockholders.

> "* * * The assessment is an incident of the incorporation. Thus the subject matter is peculiarly within the regulatory power of New York, as the State of incorporation. 'So much so,' [citation] 'that no other State properly can be said to have any public policy thereon. * * * For 'the act of becoming a member [of a corporation] is something more than a contract, it is entering into a complex and abiding relation, and as marriage looks to domicil, membership looks to and must be governed by the law of the State granting the incorporation.'" [Citation.] * * * "[64]

(b) The rights of competing stock-claimants to ownership of valid stock, depend on personal relationships and transactions to which the corporation and the domiciliary state may be indifferent. A judgment affecting the relative rights of two parties to an *in personam* action in (say) New York, and relating to title to land or chattels or stock controlled by (say) Pennsylvania, is binding on those parties and their privies, and is entitled to full faith and credit in Pennsylvania. However, the significance accorded to the New York adjudication of *title* to the property—particularly as to the rights of third persons not directly bound by the New York judgment—remains within the control of Pennsylvania.[65]

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[64] *Broderick* v. *Rosner*, 294 U. S. 629, *at* 643-4 (1935, *per* BRANDEIS, J.). *First citation: Converse* v. *Hamilton*, 224 U. S. 243, *at* 260 (1912, *per* VAN DEVANTER, J.).

[65] *Green* v. *Van Buskirk*, 5 Wall. (72 U. S.) 307 (1867, *per* MILLER, J.), 7 Wall. (74 U. S.) 139 (1869, *per* DAVIS, J.); *Fall* v. *Eastin*, 215 U. S. 1 (1909, *per* MCKENNA, J.; HOLMES, J., *concurring*, 215 U. S. *at* 15); *Bank of America Nat. Tr. & Sav. Assn.* v. *Parnell*, 352 U. S. 29 (1956, *per* FRANKFURTER, J.); *Irving Trust Co.* v. *Maryland Cas. Co.*, 83 F. 2d 168 (2d Cir., 1936, *per* L. HAND, J.), *cert. den.* 299 U. S. 571 (1936); *see Goodrich, Two States and Real Estate*, 89 U. Pa. L. Rev. 417 (1941).

These principles apply both to the stock-claimants' ownership of Nazareth *stock* if valid, and to their ownership of Nazareth *assets* if the stock is void and if a trust is impressed on the assets.

(i) There is no conflict of Pennsylvania and New York laws ("whole law" or "internal law") as to ownership of *stock*. Pennsylvania has effectually ceded absolute control over determination of stock ownership by legislating that title to shares depends on title to the share certificates, at least where the other state with "contact" has comparable law in force (as here).

During the period of the stock-purchase transactions involved in Nazareth (1951-53), both the Uniform Sales Act and the Uniform Stock Transfer Act were in force in both Pennsylvania and New York. These statutes have been supplanted by the Uniform Commercial Code, effective in Pennsylvania since 1954, and to become effective in New York in 1964. The Code makes no material change in the internal law applicable in *Nazareth;* in most respects, the Code expressly adopts and clarifies the prior internal law, both statutory and judge-made.

In both states, under the Uniform Acts and the Code, title to valid stock depends on title to the negotiable stock certificates, not on the domicile or on registration on the corporate books. The *transfer* of the stock certificates, and of the shares represented thereby, determines the applicable law on ownership among competing stock-claimants. The conflicts rules are those involving sales and transfers of chattels and other negotiable paper, and those involving promises to sell and transfer chattels and other negotiable paper.[66]

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[66] *Direction der Disconto-Gesellschaft* v. *U. S. Steel Corp.*, 267 U. S. 22 (1925, *per* HOLMES, J.); *United Cigarette Mach. Co., Inc.* v. *Can. Pac. Ry. Co.*, 12 F. 2d 634 (2d Cir., 1926, *per* MANTON, J.); *Mill* v. *Jacobs*, 333 Pa. 231, 4 A. 2d 152 (1939, *per* DREW, J.); *Soltz* v. *Exhibitors Svc. Co.*, 334 Pa. 211, 5 A. 2d 899 (1939, *per* LINN, J.); *Lesavoy Industries, Inc.* v. *Pa. Gen. Paper Co.*, 404 Pa. 161, 171 A. 2d 148 (1961, *per* COHEN, J.). *See In re Rosen*, 157 F. 2d 997, *at* 999 (3d Cir., 1946, *per* GOODRICH, J.), *cert. den.* 330 U. S. 835 (1947).

(ii) Conflict of Pennsylvania and New York internal laws does appear *contingently* in only one respect, the purchase-money resulting trust. New York has abolished that form of trust, and thus bars the remedy below. Pennsylvania, short of abolition, has so curtailed the resulting trust that its rules of decision also bar the remedy below. Conflict of laws would occur only if the federal court were to modify the purchase-money resulting trust impressed below in order to conform it to Pennsylvania internal law. The trust would still be barred by New York internal law.

The resulting trust and the constructive trust are equitable *remedies*, applied judicially as two devices among many to enforce adjudicated rights where the legal remedy is inadequate (*e.g.*, money judgment) or unavailable (*e.g.*, impression of a lien on foreign realty). The cause of action arises from fraudulent *conduct*, not from an express contract or conveyance, and is "transitory," not "local." In such situations, the situs of the realty does not determine the applicable law governing the rights of the parties *inter se*. The choice of law as to *remedial trusts* is the same as the choice of law as to *rights* arising from tortious frauds and "implied" contracts.[67]

In *Nazareth*, all the stock-claimants made their stock-purchase contracts with Malakoff in New York, and paid the price to Malakoff in New York. At least half of them received letter-receipts from Malakoff which stated: "It is contemplated that the construction, performance, and execution of our understanding shall be governed by the Laws of the State of New York." The acceptance and affirmation of those contracts constitutes a private choice of law which is

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[67] *Massie* v. *Watts*, 6 Cranch (10 U. S.) 148 (1810, *per* MARSHALL, *C. J.*); *Irving Trust Co.* v. *Maryland Cas. Co.*, *supra*, n. 65; *Coffey* v. *Managed Properties, Inc.*, 85 F. 2d 88, *at* 90 (2d Cir., 1936, *per* A. N. HAND, *J.*); *Mandley* v. *Backer*, 121 F. 2d 875 (D. C. Cir., 1941, *per* GRONER, *C. J.*); *see Goodrich*, *op. cit. supra*, n. 65.

virtually determinative here.[68] All the Nazareth stock certificates were executed and delivered to the stock-claimants in New York. Most of the stock-claimants reside in New York, as did Malakoff. In sum, a stock-claimant's ownership of a "share" or "interest" which *he* bought from Malakoff in New York, depends on New York law, whether his acquisition was by an express contract executed and to be performed in New York, or by transfer of a stock certificate in New York, or by judicial impression of a trust on Malakoff's assets in consequence of Malakoff's wrongdoing in New York. New York law would not impress a purchase-money resulting trust.

A stock-claimant's right to subtract from or subordinate another stock-claimant's "share" or "interest" similarly acquired, depends on the relative equities in the stock or the realty (depending in turn on whether corporate stock or trust "interests" are awarded). In that respect, each stock-claimant is a third party as against every other stock-claimant. If stock is awarded, the equities of third parties depend on New York law. If trust "interests" are awarded, the equities of third parties depend on Pennsylvania law. There is no conflict of laws as to the rights of third parties. The only conflict involves the *availability* of a purchase-money resulting trust, and should be resolved by applying New York law, barring such a trust altogether.

(c) As to the federal court's choice of applicable state law in nondiversity cases where conflict of state laws appears:

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[68] *Haag* v. *Barnes*, 9 N. Y. 2d 554, *at* 559-560, 216 N. Y. S. 2d 65 (1961, *per* FULD, *J.*); *Hutchison* v. *Ross*, 262 N. Y. 381, 187 N. E. 65 (1933, *per* LEHMAN, *J.*); *Industrial Packaging Products Co.* v. *Ft. Pitt Packaging Intl., Inc.*, 399 Pa. 643, 161 A. 2d 19 (1960, *per* JONES, *J.*); 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 1-105(1), P. L. 3 (1953) § 1-105, *amended* P. L. 1023 (1959) § 1; *Seeman* v. *Phila. Warehouse Co.*, 274 U. S. 403 (1927, *per* STONE, *J.*).

Here, no federal statute has even been invoked with respect to the substantive rights of the parties. The only applicable federal statute relating to choice of applicable state law, is the Rules of Decision Act itself. Its language—"The laws of the several states, * * *, shall be regarded as rules of decision * * *, in cases where they apply."—furnishes little or no guide, and has not been authoritatively interpreted on the question.

(i) If the federal nondiversity court and the state courts with "contact" would all apply the same conflicts of law rules, the choice-of-law problem would probably be as academic as if the internal laws were not in conflict. The New York courts have expressly adopted the *ad hoc* "grouping of significant contacts" or "center of gravity" rule or theory, based on the facts and the issues of the particular case, for all litigation; and the Pennsylvania legislature, by its 1959 amendment of the Uniform Commercial Code, has effectually adopted the same rule as to commercial transactions.[69] Mechanical choice-of-law formulas are eschewed. The rule is a realistic acknowledgment of what used to be judicially accomplished and rationalized by inferring "intent" and implying private stipulations of applicable law, especially to validate contracts and property transfers. This Court has suggested adoption of the same flexible "center of gravity" rule.[70] Traditional rules would also apply the law of New York—the place the stock purchase contracts with Malakoff were made and were performed by delivery of the stock certificates, and the place of Malakoff's wrongdoing.

(ii) Wolf submits that a federal bankruptcy court, applying state law under the Rules of Decision Act and no

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[69] *Auten* v. *Auten*, 308 N. Y. 155, 124 N. E. 2d 99 (1954, *per* FULD, *J.*); *Haaa* v. *Barnes*, *supra*, n. 68; 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 1-105 (1), P. L. 3 (1953) § 1-105, *amended* P. L. 1023 (1959) § 1.

[70] *See Cope* v. *Anderson*, 331 U. S. 461 (1947, *per* BLACK, *J.*). *See also* 1A Moore's Fed. Prac. (2d ed. 1961) ¶ 0.325.

other federal statute in a *commercial* nondiversity case, should make a *provisional* choice of state law based on the federal court's own "grouping of significant contacts"— a mixed question of fact and law. The state law chosen should be the *whole law* (which is what would make the federal court's choice provisional), particularly because state legislatures are incorporating choice-of-law provisions into *commercial* statutes, notably the Uniform Commercial Code.

(iii) The forum state's conflict-of-laws rules should be applied to the remedies and the "procedural" defenses only if the parties might reasonably have litigated the same matter in a state forum in that state.

The contingent conflict of laws in this case relates to the availability of an equitable *remedial* trust under state law, and is an example of the most serious conflict-of-laws problems which relates to defenses and remedies peculiar to the litigation process itself rather than to pre-litigation rights and liabilities (*e.g.*, time-bars, "public policy" against enforcement of a claim or defense created by foreign state law). *Klaxon*, following *Erie*, held that there was no "independent 'general law' of conflict of laws" in *diversity* cases; the *forum* state's conflict-of-laws rules governed the federal diversity court in all respects, because the federal court was sitting as "only another court of the State."[70a]

The Chapter X court has no such relationship to the forum state in summary proceedings involving the allowance of claims. More importantly, the litigation of disputed ownership of the debts or stock underlying the claims, by way of cross-claims between the claimants, has no relationship to the forum state, especially when there is no serious question of allowance of the claim as against the debtor. That is the situation here. The Debtor chose a New York

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[70a] *Klaxon Co. v. Stentor Electric Mfg. Co., Inc.*, 313 U. S. 487 (1941, *per* REED, J.). *Cf. Griffin v. McCoach*, 313 U. S. 498 (1941, *per* REED, J.) (*interpleader*).

forum for convenience; any impropriety was a matter of "venue," not "jurisdiction," and waivable.[70b] The stock-claimants appeared generally in response to bar orders, to avoid forfeiture of stock which was *not* worthless because the Debtor was *not* insolvent in the bankruptcy (balance sheet) sense. (Otherwise, the stock-claimants would not have filed claims, and the Debtor's recourse would have been plenary actions in New York to collect assessments for the benefit of creditors.) If the Debtor had filed its Chapter X petition in Philadelphia, and had brought the stock-claimants into proceedings there, the application of Pennsylvania conflict-of-laws rules could not be justified simply by reference to the forum state. New York conflict-of-laws rules as to remedies and "procedural" defenses *incident to the litigation*, should be applied here by a federal nondiversity court *because* New York is where the stock-claimants would hypothetically have litigated the disputed *ownership* of Nazareth stock, except for the happenstance of the Debtor's Chapter X petition and the Debtor's challenge to *validity* of all outstanding Nazareth stock. A New York court, even if it decided to award "interests" in Nazareth *assets*, would not impress a purchase-money resulting trust as an equitable remedy.

[70b] *See* 6 *Collier on Bankruptcy* (14th ed.) ¶ 4.11.

B. Having received the Market (realty and business) in consideration of the issuance of all its authorized shares of stock, the Debtor and its stockholders derivatively are not aggrieved by the validation and allowance of the entire authorized issue of 200 shares, pursuant to applicable state rules of decision.

The decisions below stand—or fall—on the conclusion of law that *all* outstanding Nazareth shares are absolutely void under Pennsylvania law, on the ground of lack of consideration to Nazareth for issuance of those shares. The Examiner stated, and the District Judge implicitly concurred:

> "91. * * * not one of the thirty-six persons who have filed proofs of stock interest * * * has a clear legal right to any of the shares which he or she claims. * * * all of the issued shares of stock of the debtor herein are at least voidable." (R. 192)
>
> "92. * * * The factual objection that no consideration passed to the debtor must be sustained. That is true as to all stock claims. Consequently on the basis of the debtor's objections there would be no stockholders. * * *" (R. 192-3)
>
> "136. If the claimants-stockholders invested in Nazareth the business enterprise and not Nazareth, the corporate entity, there is no problem of consideration to the debtor itself. Consideration to Malakoff can be treated as consideration to the debtor, justifying the sustaining of the claims of stock interest interposed by the claimants-stockholders herein on the basis of such consideration. * * *" (R. 207)

Speaking for the Court of Appeals, Judge Moore wrote:

> "* * * From these persons [disallowed] the Debtor did not receive and was not intended to receive anything of value, either from them or *from Malakoff*.

> These shares as a matter of Pennsylvania law could have had no validity as an original issue. * * *" (R. 591; *emphasis supplied.*)
>
> "Despite the cloud of illegality obscuring *any* stock issuance, the Debtor came into corporate being and did acquire a valuable property which it still holds. *The Market property is sufficient to support a valid stock issue* to those entitled thereto. The sellers (Philadelphia group) have been paid for that property *by Malakoff*. * * *" (R. 592; *emphasis supplied.*)

In other words, the Market was paid for by Malakoff, and is sufficient consideration under Pennsylvania law for the issuance of *new* stock for purposes of a plan of reorganization—but the Market is *not* sufficient consideration under Pennsylvania law for the issuance of *old* stock for purposes of the allowance of claims!

1. *The first 20 shares of Nazareth stock were regularly issued for sufficient consideration to Nazareth, and remain valid and outstanding, notwithstanding irregularity in their transfer.*

Both Courts recognized that the first 20 shares had been *validly* issued to the representatives of the Philadelphia Group (*viz.*: Zoloth and Soble), and had been sold by them to Malakoff (R. 54-7, 185-6, 231, 588-9, 592). To support their common thesis that *all* outstanding shares were void, both Courts below had to disregard those first 20 shares. They did. The rationale was stated by Judge Moore, thus:

> "* * * The 20 *shares* originally issued to Zoloth and Soble, although subsequently assigned to Malakoff and still later by him to the Debtor, did not come into the *hands* of any claimant. * * * *Thus* no claimant can derive any rights by assignment from Malakoff on the theory that he was the owner of the Debtor's stock. * * *" (R. 592; *emphasis supplied.*)

That statement is erroneous. It was the share *certificates*—not the shares—which "did not come into the hands of any claimant."

(a) What Judge Moore is saying, is that Malakoff, by assigning to Nazareth the first two *certificates*, and the first 20 validly issued shares represented by those certificates, cut off any rights in those shares which any of the stock-claimants here might have had. If Malakoff had merely surrendered or cancelled the 20 shares, the transaction would have approximated the usual indorsement and delivery of the certificates to the purchasers, plus submission of those certificates to the issuer-corporation for transfer of the shares on the corporate books and for issuance of new certificates to the purchasers. The transactions, and Judge Moore's statement, are meaningful only if Nazareth was acquiring treasury shares validly issued. Malakoff's assignment to Nazareth is governed by the same principles as Malakoff's assignment to any individual stock-claimant.[71]

"*Title* to a certificate *and* to the *shares* represented thereby can be transferred only" by delivery of the *indorsed* certificate or by delivery of the certificate *accompanied* by a separate instrument of assignment or stock power,[72] "'Title' means legal title and does not include a merely equitable or beneficial ownership or interest."[73] Thus, the common-law doctrine that legal title passed upon transfer of the shares on the corporate books, has been supplanted by importing negotiability to stock certificates.[74] As *among competing*

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[71] *See, e.g., Moores* v. *Citizens Nat. Bank*, 111 U. S. 156 (1884, *per* GRAY, *J.*).

[72] N. Y. Pers. Prop. L. (L. 1913, c. 600) (49 McKinney's N. Y. Consol. L.) § 162; 15 Purdon's Pa. Stats. Ann. § 301, P. L. 126, § 1 (1911) (*repealed* 1954); Uniform Stock Transfer Act, § 1 (*emphasis supplied*).

[73] N. Y. P. P. L. § 183(1); 15 Purdon's Pa. Stats. Ann. § 322 (1); U. S. T. A., § 22(1) (*supra*, n. 72).

[74] *Soltz* v. *Exhibitors Svc. Co.*, 334 Pa. 211, *at* 215, 5 A. 2d 899 (1939, *per* LUSK, *J.*).

stock-claimants, "legal title" to shares depends on ownership of a negotiable certificate; the corporate books are immaterial (much as the corporation's accounts-payable ledger is not definitive of ownership of a debt evidenced by a negotiable note). *As between the issuer-corporation and competing stock-claimants*, the old doctrine about transfer on the corporate books, at least where adopted in the corporate charter or by-laws (as here [75]), continues to protect the corporation—for purposes of dividend payments, stockholder voting, and assessment.[76]

But "legal title" to a certificate (and the shares) prevails over a prior assignment of those shares unaccompanied by the certificate *only* "if * * * another person, for value in good faith, *and without notice of the prior transfer*, shall purchase and obtain delivery of such certificate * * *." [77] The earlier assignment is not nugatory though unaccompanied by the certificate; and the certificate is not the *sine qua non* of assignment. The certificate relates to negotiability and to defenses and equities among competing stock-claimants.[78]

> "§ 171. An attempted transfer of title to a certificate *or* to the *shares* represented thereby without delivery of the certificate shall have the effect of a promise to transfer and the obligation, if any, imposed

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[75] Nazareth By-Laws, Art. VIII, § 2; Saul General Examiner's Exh. I; R. 168 [*not printed*].

[76] N. Y. P. P. L. §§ 162, 164; 15 Purdon's Pa. Stats. Ann. §§ 301, 303, U. S. T. A. §§ 1, 3 (*supra*, n. 72).

[77] N. Y. P. P. L. § 165; 15 Purdon's Pa. Stats. Ann. § 304; U. S. T. A. § 4 (*supra*, n. 72) (*emphasis supplied*).

[78] *Parsons* v. *Life*, 158 M. 32, 280 N. Y. S. 60 (Sup., Onondaga, 1933, *per* SMITH, *J.*), *aff'd* [*sub nom. Parsons* v. *First Tr. & Dep. Co.*] 243 A. D. 681, 277 N. Y. S. 426, 428 (4th Dept., 1935, *per*), *aff'd* 269 N. Y. 630, 200 N. E. 31 (1936, *memo*); *Suchy* v. *Frankenberg*, 251 A. D. 349, 296 N. Y. S. 545 (1st Dept., 1937, *per* UNTERMYER, *J.*); Connell's *Estate*, 282 Pa. 555, 128 A. 503 (1925, *per* SADLER, *J.*); *Citizens' Nat. Bank* v. *Ircin B. & L. Assn.*, 316 Pa. 536, 175 A. 399 (1934, *per* FRAZER, *C. J.*); *Leff* v. *N. Kaufman's, Inc.*, 342 Pa. 342, 20 A. 2d 780 (1941, *per* DREW, *J.*).

by such promise shall be determined by the law governing the formation and performance of contracts." [79]

By the time Nazareth acquired the first 20 shares on June 17, 1953, Malakoff had made his stock-purchase contracts with *all* 36 stock-claimants here, and had thereby promised them shares of Nazareth stock—mostly at times when the only shares to which he himself had legal title were those same 20 shares evidenced by those same first two stock certificates. Nazareth was not "without notice of the prior transfer" of shares by Malakoff: Malakoff had been president of Nazareth, and the Nazareth books themselves reflected the prior issuance of shares sold by Malakoff.

(b) The first 20 *shares*, represented by the first two stock certificates, did pass to some of the stock-claimants. The foregoing principles determine their rights, *inter se*, to those shares. Since none of them had ever acquired delivery of the certificates, "legal title" to the shares remained in Malakoff. As stated in an apposite New York case (where one Frankenberg had first pledged stock certificates without indorsing them, then had sold the same shares without delivering the certificates):

> "* * * The legal title remained at all times in Frankenberg since it had not been transferred either to the plaintiff or to the corporate defendant in the only manner in which the statute (Personal Property Law, § 162) provides that it may be done. The plaintiff did not acquire the legal title because he failed to secure indorsement of the certificates; the corporation did not acquire legal title because it failed to secure delivery of the certificates properly indorsed.

[79] N. Y. P. P. L. § 171; 15 Purdon's Pa. Stats. Ann. § 310; U. S. T. A. § 10 (*supra*, n. 72) (*emphasis supplied*). *See also* N. Y. P. P. L. § 179; 15 Purdon's Pa. Stats. Ann. § 318; U. S. T. A. § 18 (*supra*, n. 72).

"In the presence of such conflicting equities, the rule of law is settled that 'the one that is *prior in time is superior in right.*' [Citation.] * * *"[80]

The priorities of competing claimants, both holding equities of ownership, but neither holding legal title, are determined as of the times they acquired their respective equities. The later-acquired equity, otherwise inferior to the earlier, is *not* elevated to superiority by the mere acquisition of legal title without new contemporaneous consideration *then*.[81] *Legally*, every delivery of a Nazareth stock certificate 18 months after payment to Malakoff for those shares, was in consideration of an "antecedent debt."

In *Nazareth*, one stock-claim (at least) carries an absolute right to part of those first 20 shares, *viz.*: the stock-claim of Charles Kanter (one of Wolf's assignors). Early in February of 1953, Kanter received Certificate No. 4 for 12 shares, dated February 2, 1953. The Nazareth stock certificate book —the only Nazareth record of its stockholders (R. 187)— registered that issuance. Kanter had paid Malakoff $4,000 on April 10, 1951, contemporaneously with Kanter's agreement with Malakoff that Kanter was to receive $\frac{1}{4}$ of Malakoff's $\frac{1}{4}$ interest in what was then the Philadelphia Group joint venture in the Market. Kanter's $4,000 advance to Malakoff has been judicially traced into Malakoff's down-payment to the Philadelphia Group for the purchase of the Market. Kanter was expressly exonerated of any participation in Malakoff's machinations, and of any knowledge thereof (R. 57-63, 230, 232, 595). Kanter was thus the beneficiary of an express trust in $\frac{1}{4}$ of Malakoff's shares, or a $\frac{1}{16}$ interest in the Nazareth Market, and in the corporation when later

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[80] *Suchy* v. *Frankenberg*, *supra*, n. 78, 296 N. Y. S. at 548 (*emphasis supplied*). *See cases cited supra*, n. 78.

[81] *See Central Trust Co.* v. *West India Improvement Co.*, 169 N. Y. 314, 62 N. E. 387 (1901, *per* Gray, J.); *Suchy* v. *Frankenberg*, *supra*, n. 78.

organized, whether Malakoff's shares amounted to 20 or 200; and Kanter could have enforced that trust as against Malakoff, whether Kanter be viewed as a joint venturer of Malakoff's[82] or as a pre-incorporation subscriber to Nazareth stock.[83] The issuance to Kanter of the 12 shares represented by Certificate No. 4, legally perfected his rights to those shares, theretofore cognizable in equity.

(c) If those same principles determined equitable ownership of Nazareth shares additional to the first 20—however many were validated, if less than all 262 outstanding—then the simple sequence of purchases from or through Malakoff would govern. Every stock-claimant would be denied the status of a "*bona fide* purchaser for value and without notice" of prior transfers; no stock-claimant could cut off anyone's earlier-acquired equities in Nazareth "shares". For the stock-claimants all acquired certificates directly from Nazareth (excepting a few purchasers at the end), without negotiation to constitute them holders in due course. Their equities depend equally on transactions with Malakoff. The Court of

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[82] *Nastasi* v. *Moore*, 7 M. 2d 226, 156 N. Y. S. 2d 521 (Sup., N. Y., 1956, *per* McGIVERN, *J.*); *East Lake Lumber Co.* v. *Van Gorder*, 105 M. 704, 174 N. Y. S. 38 (Sup., Erie, 1919, *per* COLE, *J.*), *aff'd* 188 A. D. 997, 177 N. Y. S. 914 (4th Dept., 1919, *memo*).

[83] *Bole* v. *Murray*, 233 Pa. 589, 82 A. 943 (1912, *per* STEWART, J.); *Bole* v. *Fulton*, 233 Pa. 609, 82 A. 947 (1912, *per* STEWART, *J.*); *Schwartz* v. *Mfrs. Cas. Ins. Co.*, 335 Pa. 130, 6 A. 2d 299 (1939, *per* DREW, *J.*); *Burr* v. *Wilcox*, 22 N. Y. 551 (1860, *per* CLERKE, SELDEN, *JJ.*); *Yonkers Gazette Co.* v. *Taylor*, 30 A. D. 334, 51 N. Y. S. 969 (2d Dept., 1898, *per* HATCH, *J.*); *Beals* v. *Buffalo Expanded Metal Constr. Co.*, 49 A. D. 589, 63 N. Y. S. 635 (4th Dept., 1900, *per* SPRING, *J.*); *Sanders* v. *Barnaby*, 166 A. D. 274 151 N. Y. S. 580 (1st Dept., 1915, *per* SCOTT, *J.*); *Mills* v. *Friedman*, 111 M. 253, 181 N. Y. S. 285 (Sup., Albany, 1920, *per*, HINMAN, *J.*), *aff'd* 194 A. D. 942, 184 N. Y. S. 613 (3d Dept., 1920, *p.c.*); *Mills* v. *McNamee*, 111 M. 253, 181 N. Y. S. 285 (Sup., Albany, 1920, *per* HINMAN, *J.*), *aff'd* 194 A. D. 932, 184 N. Y. S. 613 (3d Dept., 1920, *p.c.*), *aff'd* 233 N. Y. 517, 135 N. E. 899 (1922, *memo*); Applications of Friedman, 184 M. 639, 54 N. Y. S. 2d 45 (Sup., N. Y., 1945, *per* MILLER, *J.*), *mod.* 269 A. D. 834, 56 N. Y. S. 2d 516 (1st Dept., 1945, *p.c.*).

Appeals' classification of the stock-claimants was based on the finding that some or all of the consideration for the stock cancelled below (*i.e.*, the disallowed stock-claims) was credit for antecedent indebtedness to Malakoff himself, and on the finding and/or conclusion that, as to those whose stock-claims were allowed, "Malakoff as the promoter must be regarded as a trustee, fiduciary, agent, promoter or syndicator (the terminology is unimportant—the facts create the rights) for those who gave him their funds for investment in the project" (R. 592-4). So the Debtor and the Weinstein-Fried Group had advocated (R. 47-50, 191).

True, an antecedent debt does not support a "good-faith purchase" or an estoppel sufficient to cut off prior equities.[54] But *notice*, too, disqualifies the would-be "good-faith purchaser." The Court of Appeals' decision would impute such disqualifying notice to *all* the stock-claimants who prevailed below *because* Malakoff was their agent or trustee in their acquisitions of Nazareth "shares". Malakoff was the "sole actor" for them.

> "Under these circumstances, we do not think the company can be treated as a *bona fide purchaser*. It is charged with Holbrook's knowledge because he was the *sole actor* for the company in procuring the fraudulent [land] patents.* * *"
>
> "* * * It is true that the more titles he got the more profit he would make out of the agency, and we may assume that, as between him and the company, in securing fraudulent titles for the company, he was violating his instructions; but he and the company were in a common adventure, and if the company insists on retaining the fruits of that adventure, it must be charged with the knowledge of the agent through

[54] *See, e.g., Wills* v. *Investors Bankstocks Corp.*, 257 N. Y. 451, *at* 458, 178 N. E. 755 (1931, *per* LEHMAN, *J.*).

> whom the fruits came.* * * The adverse interests, as between them, in sharing the fruits of the common business, cannot enable the company to retain its share and repudiate the agent with all he knew. * * *" [85]

Thus, with one class on "notice", and the other not having paid contemporaneous "value", all hold equally infirm titles; and equity would fall back on the maxim, "prior in time is superior in right". The calendar—or chance—would dictate: and the latest purchasers would be excluded.

No such result is advocated by any of the parties; no such result was reached by either Court below; and, fortunately, no such result is necessary here.

2. *Sufficient consideration passed to Nazareth to support its issuance of 200 outstanding shares, notwithstanding irregularity in the issuance of 180 shares.*

The *only* ground (other than overissue) for voiding corporate stock under Pennsylvania law, is lack of consideration to the issuer-corporation for such stock. Irregularities in the issuance, even statutory violations, will not void the stock. Irregularities abounded in the issuance of Nazareth stock; but there was no lack of consideration for the issuance of 200 shares. The Pennsylvania Business Corporation Law provides:

> "§ 610. Validity of Shares.—The fact that shares are issued in violation of, or without full compliance with, the provisions of this act *shall not make the shares so issued invalid*, unless they are issued in

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[85] Curtis, Collins, & Holbrook Co. v. U. S., 262 U. S. 215, *at* 222, 224 (1923, *per* TAFT, *C. J.*). *Accord: Munroe* v. *Harriman*, 85 F. 2d 493 (2d Cir., 1936, *per* SWAN, *J.*), *cert. den.* 299 U. S. 601 (1936); *Holden* v. *N. Y. & Erie Bank*, 72 N. Y. 286 (1878, *per* FOLGER, *J.*); *Scouton* v. *Stony Brook Lumber Co.*, 261 Pa. 241, *at* 246, 104 A. 548 (1918, *per* WALLING, *J.*).

violation of Article XVI, Section seven, of the Constitution of this Commonwealth." [86]

The Pennsylvania Constitution provides:

> "[XVI] § 7. No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * *" [87]

(a) What both Courts below have ignored, is that the statutory protection runs to the issuer-corporation. If the corporation receives consideration, the stock is valid—notwithstanding that the person who pays the consideration is not the recipient of the stock.

> "* * * the Smoaks did not pay any money or transfer any property to the corporation, or perform any labor for it, in payment for the stock issued to them. * * * *The statute does not require that corporation stock must be paid for by the money, labor or property of the person to whom it is issued. It merely requires that the corporation shall receive full value for all of the stock issued.* This requirement was fully met by the conveyance to the corporation by the plaintiff of property whose value was far in excess of the amount of the capital stock. The fact that plaintiff had entered into an agreement to issue one-half of this stock to the defendant Smoak or his nominee, and that such agreement was performed, in no way alters the fundamental proposition that the corporation itself had received full value. This was sufficient to satisfy the statute, and in the absence of fraud, plaintiff may not

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[86] Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P. L. 364, Art. VI; § 610 (1933) (*emphasis supplied*).

[87] Pa. Const. Art. XVI, § 7 (1874, 1956). *See* Pa. Bus. Corp. L. § 603A (*supra*, n. 86).

> void his contract [with Smoak] on the theory of a statutory violation." [88]

(b) Having received the Market (realty and business), and having paid therefor in stock alone—not money—it is really beyond reasonable question that Nazareth received *some* consideration for the issuance of *some* of its stock. Reasonable question can be addressed only to *how much* Nazareth received; whether the consideration was *sufficient* to support issuance of *all* the outstanding shares (not to exceed 200); and, if not, *how many* shares are supported by the consideration received by Nazareth in fact.

Judge Moore stated, "The Market property [paid for by Malakoff] is sufficient to support a valid stock issue to those entitled thereto." (R. 592) So the District Judge and the Examiner had said. No reason is given—and there is no reason—why the Market should not be sufficient in *value* to support a valid stock issue—old or new—to *all* the stock claimants.

The Examiner found that the price of the Market to Malakoff was $89,989 (R. 57). The District Judge found that the price of the Market to Malakoff was $66,000 "plus an unresolved amount." (R. 231) The District Court awarded "shares" or "interests" in Nazareth to all 36 stock-claimants in No. 27000 (excluding and reserving the Margolis Group), who had paid Malakoff an aggregate, in "net fair value of investment in the debtor," found to be $173,457.53 (R. 263). Judge Moore stated that Malakoff had paid the Philadelphia Group $77,010.84 (R. 589). The Court of Appeals awarded "shares" or "interests" in Nazareth to 33 of

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[88] *Winston* v. *Saugerties Farms, Inc.*, 262 A. D. 435, 29 N. Y. S. 2d 292, *at* 296 (3d Dept., *per* FOSTER, *J.*), *aff'd* 287 N. Y. 718, 29 N. E. 2d 934 (1942, *p.c.*). *Accord: Schmidt* v. *Paul*, 377 Pac. 377, 105 A. 2d 118 (1954, *per* STEARNS, *J.*); *Nastasi* v. *Moore*, 7 M. 2d 226, 156 N. Y. S. 2d 521 (Sup., N. Y., 1956, *per* MCGIVERN, *J.*).

the 41 stock-claimants in No. 27000 and No. 26962 (including some of the Margolis Group), who had paid Malakoff an aggregate, in "investment" in the Market, found to be $145,287.34 (R. 594-5, 598).

Neither Court below had the slightest concern for any *per-share* consideration to Nazareth in dollars. The Judges and the parties—were indifferent to the actual value of the Market, and to Malakoff's profits in selling "shares" to the stock-claimants. The Market was to constitute the consideration to Nazareth for issuance of *all* the shares judicially validated, irrespective of how many such shares. Thus, the Market is sufficient consideration to validate any number of Nazareth shares now issued and outstanding—within the authorized limit of 200.

(c) The defects in issuance of Nazareth shares (apart from overissue) are matters of *irregularity, not invalidity.*

The validity of the first 20 shares has been discussed above. The other 180 shares within the authorized limit of 200, have been challenged because the attempt to regularize their issuance occurred subsequent to issuance, and because the corporate records erroneously stated the consideration to Nazareth for that issuance. Judge Moore wrote:

> "After the shares had been issued to the claimants from and after February 2, 1953, corporate minutes in May or June, 1953, were fraudulently prepared and pre-dated as of July 2, 1952 (or post-dated July 2, 1953) purporting to evidence the issuance of the remaining 180 shares to Malakoff for $75 a share. There is no proof that Malakoff ever paid for these shares or that they were legally issued. Thus no claimant can derive any rights by assignment from Malakoff on the theory that he was the owner of the Debtor's stock. The purported issuance was both fraudulent and invalid." (R. 592)

The Nazareth minutes referred to, expressly stated that the price of the 180 shares was to be the same $75 per share as the price of the first 20 shares, and that the aggregate price of $13,500 for the 180 shares was to be charged against Nazareth's loans payable to Malakoff, then shown on the Nazareth books as $66,092.92 (Saul General: Examiner's Exh. I; R. 535-6, 168).

A corporation may validly act without formal meetings of stockholders and directors, and without formal minutes and resolutions. The corporate records are not conclusive; parol evidence is admissible to clarify and correct. In the event of controversy, it devolves upon the courts to penetrate the fictions on the records and to ascertain the realities.[89]

The amount of consideration—the subscription price—to be paid to the corporation for an original issuance of *no-par* shares, is determined by the incorporators before incorporation, and by the directors after incorporation. Where the subscription price is paid in property rather than money (as in *Nazareth*), the valuation of that property by the incorporators or directors is conclusive, absent actual fraud.[90] The consideration for the shares need not be pre-paid. The time of payment of the subscription price is expressly left by statute to the discretion of the incorporators or directors and to the subscription contracts.[91]

The realities in *Nazareth* are that Malakoff himself paid the Philadelphia Group at least $60,000 for the Market

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[89] *E.g., Schmidt* v. *Paul*, 377 Pa. 377, 105 A. 2d 118 (1954, *per* STEARNE, *J.*); *Moss* v. *Averell*, 10 N. Y. 449 (1853, *per* WILLARD, *J.*); *Handley* v. *Stutz*, 139 U. S. 417 (1891, *per* BROWN, *J.*).

[90] Pa. Bus. Corp. L. § 603A (*supra*, n. 86). *See Maguire* v. *Osborne*, 388 Pa. 121, 130 A. 2d 157 (1957, *p.c.*); *Schmidt* v. *Paul*, *supra*, n. 89.

[91] Pa. Bus. Corp. L. § 604 (*supra*, n. 86); *Petrishen* v. *Westmoreland Fin. Corp.*, 394 Pa. 552, 147 A. 2d 392 (1959, *per* JONES, *J.*); *Grafton* v. *Masteller*, 232 F. 2d 773 (3d Cir., 1956, *per* HASTIE, *J.*), *cert. den.* 352 U. S. 832 (1956).

(assets) and for *all* the issued and outstanding Nazareth shares, and that the first 20 shares were later split, 10-for-1. The 200 authorized shares should have been capitalized at no less than $60,000 after Malakoff released his claim to the loans payable by Nazareth and after he released all his interest in shares in his name. Indeed, it would be still more accurate for the corporation's acquisition cost to be shown on its books as $89,989, the total price Malakoff agreed to pay the Philadelphia Group for the Market (assets) *plus* the first 20 shares—*i.e.*, the total price for which the Philadelphia Group credited Malakoff.

Good accounting practice warrants appraisal of tangible assets, especially realty, and re-valuation on the books, in order to portray asset value and net worth accurately.[92] The Pennsylvania Business Corporation Law makes express provision for such re-valuation of assets to determine "capital" and "surplus" incident to certain statutory protection to creditors and stockholders.[93]

The minutes were drafted and signed in May and June of 1953. Malakoff had previously delivered every stock certificate. On July 2, 1953, he released his entire claim against Nazareth. The minutes induced no stock-claimant to change his position to his detriment. The fraud is academic. If those minutes had stated that Malakoff *then* released his

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[92] *See* Wixon, Accountants Handbook (Ronald, 1957), §§ 18:1-8, 18:22-36, 18:40-42, 19:14-16, 22:6-7.

[93] *E.g.*, Pa. Bus. Corp. L. §§ 701A(1), 701B; 15 Purdon's Pa. Stats. Ann. §§ 2852-701A(1), 701B; P. L. 364, Art. VII, § 701A(1), 701B (1933), *amended* P. L. 1123, § 1 (1935); *effectually recodified as* § 704B *by* P. L. 711, § 1 (1957). *See* Mulford, Corporate Distributions to Shareholders and Other Amendments to Pa. Bus. Corp. Law, 106 U. Pa. L. Rev. 536, at 544-5 (1958). *See also Edwards* v. *Douglas*, 269 U. S. 204 (1925, *per* BRANDEIS, *J.*); *Mountain State Steel Foundries, Inc.* v. *C. I. R.*, 284 F. 2d 737 (4th Cir. [W. Va.], 1960, *per* HAYNSWORTH, *J.*); *Randall* v. *Bailey*, 288 N. Y. 280, 43 N. E. 2d 43 (1942, *per* CONWAY, *J.*).

claim against Nazareth to *all* loans payable to him (not limited to $13,500), and that all 200 authorized shares were to be issued to Malakoff's designees for an aggregate consideration to Nazareth of between $60,000 and $90,000, those minutes would have been an accurate reflection of the financial realities of the Nazareth stock issuance. Thereby, those minutes would have stated in substance, what both Courts below have ruled in substance, *viz.*: that Malakoff paid the Philadelphia Group for the Market, and that the Market was consideration—and sufficient consideration—for the issuance of 200 shares to Malakoff's designees (purchasers). In short, those 1953 minutes require correction, not disregard.[94]

3. *Assessment of the unpaid subscription price is the state remedy prerequisite to cancellation of shares of stock, in order to permit redemption and to avoid forfeiture.*

(a) The Pennsylvania Constitution provides:

> "[XVI] § 7. No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * *"[95]

But the remedy is *not* cancellation of stock:

> "* * * However, the Pennsylvania cases are agreed that this constitutional provision [Art. XVI, § 7] standing alone, does not cause the issuance of stock without prepayment to be void. Rather, it is necessary that the legislature shall *implement* the constitutionally stated policy by a statute declaring the nature and extent of any infirmity which attaches

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[94] *See Coleman* v. *Huffman*, 8 Monroe L. R. 97 (C. P., Monroe, 1946, *per* BODIE, *P. J.*), *aff'd* 357 Pa. 232, 53 A. 2d 60 (1947, *per* STERN, *J.*).

[95] Pa Const., Art. XVI, § 7 (1874, 1956). *See* Pa. Bus. Corp. L. § 603A; 15 Purdon's Pa. Stats. Ann. § 2852-603A; P. L. 364, Art. VI, § 603A (1933).

to the stock so issued, and *what may be done about it*. [Pa. cases cited.]" [96]

(b) The Pennsylvania Business Corporation Law has "implemented" the Pennsylvania constitutional policy, in detail. The remedy for lack of consideration to the corporation for stock issued, is *assessment* or call—collectible like any other debt, and secured by a lien on the shares themselves. Cancellation may be effected *only* after foreclosure of the corporate lien on the stock, and then *only* if public sale brings no purchase or if the corporation fails to collect a money judgment for the deficiency.

> "§ 604. * * * Any call made by the board of directors for payment of subscriptions shall be uniform as to all shares of the same class, * * *. The directors shall cause notice of the amount of any call, and of the time and place of payment, to be given at least thirty days before the date the call is due; * * *. If a shareholder be indebted to a business corporation on account of unpaid subscriptions for shares, the corporation shall have a lien upon such shares for such indebtedness. * * *" [97]
>
> "§ 605. When any shareholder fails to pay any call upon his shares properly made by the directors, at the time when such payment is due, the directors

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[96] *Grafton* v. *Masteller*, 232 F. 2d 773, *at* 775 (3d Cir., 1956, *per* HASTIE, *J.*), *cert. den.* 352 U. S. 832 (1956) (*Pa. forum; diversity jurisdiction; emphasis supplied*). *Citing (accord): Yetter* v. *Del Valley R. Co.*, 206 Pa. 485, 56 A. 57 (1903, *per* BROWN, *J.*); *Grange Nat. Bank* v. *Collman*, 306 Pa. 201, 159 A. 26 (1932, *per* FRAZER, *C. J.*); *Bradford County Telephone Co.* v. *Young*, 329 Pa. 433, 198 A. 96 (1938, *per* STERN, *J.*); *In re Dissolution of* New Oxford Shoe Co., 45 Pa. D. & C. 53 (C. P., Adams, 1941, 1942, *per* SHEELY, *P. J.*). *Accord: Kathiotes* v. *Mosler*, 89 Pa. D. & C. 174 (C. P., Phila., 1955, *per* ALESSANDRONI, *J.*); *Bell* v. *Aubel*, 151 Pa. Super. 569, 30 A. 2d 617 (1943, *per* RHODES, *J.*). *See also Petrishen* v. *Westmoreland Fin. Corp.*, 394 Pa. 552, 147 A. 2d 392 (1959, *per* JONES, *J.*).

[97] Pa. Bus. Corp. L. § 604; 15 Purdon's Pa. Stats. Ann. § 2852-604; P. L. 364, Art. VI, § 604 (1933).

> may proceed to collect the amount due in the same manner as any debt due the corporation, or they may sell, at public sale, such part of the shares of the delinquent shareholder as will pay all or any part of the installments then due from him. * * *. If no bidder can be had to pay the amount due on the shares, if the amount is not collected by an action at law * * *, the shares shall be forfeited to the corporation and the amount previously paid in by the delinquent shareholder on the shares shall be forfeited to the corporation. * * * "[98]

Transferees of subscriptions (as well as issued shares) are exonerated from personal liability for unpaid subscriptions if their acquisitions were made "in good faith, and without knowledge or notice that the full consideration therefor has not been paid, * * *."[99] The corporation's foreclosure of any lien on the stock—including a lien for the subscription price—is barred where (as here) the stock certificates issued by the corporation bear no statement asserting such a lien.[100] The common law has been changed, and the rigorous principles of estoppel have been relaxed in favor of the transferee, as to both his personal liability to assessment[101] and the *in rem* charge on his shares for prior secret liens.[102]

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[98] Pa. Bus. Corp. L. § 605 (*supra*, n. 97).

[99] Pa. Bus. Corp. L. § 609 (*supra*, n. 97).

[100] 15 Purdon's Pa. Stats. Ann. § 315; P. L. 126, § 15 (1911) (*repealed* 1954); Uniform Stock Transfer Act § 15; N. Y. Pers. Prop. L. (L. 1913, c. 600) (49 McKinney's N. Y. Consol. L.) § 176. *Cf.* 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] §§ 8-103, 8-204; P. L. 3, §§ 8-103, 8-204 (1953, *eff.* 7/1/54). *See Bubbis* v. *Duffy & Bros., Inc.*, 14 Pa. D. & C. 281 (C. P., Phila., 1930, *per* ALESSANDRONI, *J.*); *see also French* v. *Harding*, 235 Pa. 79, 83 A. 586 (1912, *p.c.*).

[101] *Cf. Schmitt* v. *Kulamer*, 267 Pa. 1, 110 A. 169 (1920, *per* KEPHART, *J.*); *Pullman* v. *Upton*, 96 U. S. 328 (1878, *per* STRONG, *J.*); *Sigua Iron Co.* v. *Brozen*, 171 N. Y. 488, 64 N. E. 194 (1902, *per* MARTIN, *J.*).

[102] *Cf. Sproul* v. *Standard Plate Glass Co.*, 201 Pa. 103, 50 A. 1003 (1902, *per* MITCHELL, *J.*); *Fidelity & Dep. Co. of Md.* v. *Hunt*, 107 F. 2d 43 (3d Cir., 1939, *per* CLARK, *J.*).

The foregoing legislation, and the local judicial interpretation thereof, manifest a clear and fair policy in the Pennsylvania law of corporations. A stockholder of record is entitled to an opportunity of redemption (so to speak) before his shares are cancelled or forfeited. Lack of consideration for shares establishes a contract liability to the issuer-corporation, and a lien on the shares to secure that liability. Notwithstanding the constitutional language that the shares are "void" for lack of consideration, the issuer-corporation must exhaust its rights and remedies as creditor and lienholder before it can look to the forfeiture contemplated by the Constitution. The stockholder does not litigate liability to the corporation for the consideration unpaid on his shares, at peril of losing his shares if the consideration is held unpaid. "[T]he shares shall be *forfeited* to the corporation" *only* "*If* no bidder can be had to pay the amount due on the shares, [*and*] *if* the amount is not collected by an action at law * * *." [103]

The stockholder's right of redemption is valuable in a rising market, as here. Management, by a selective call and lawsuit (or appeal), cannot forfeit stock to the issuer (and indirectly to the other stockholders) for lack of prepayment.

(c) The issuer-corporation has the option either to sue the stockholder for the unpaid subscription price, or to foreclose on the shares.[104] The Debtor chose the former course. The Chapter X summary proceedings afforded the Debtor the same opportunity as a local action to obtain the relief prescribed by Pennsylvania law, *viz.*: assessment, prerequisite to forfeiture of shares. The Debtor could—and did—sue *all* the stock-claimants (who had all appeared generally) for the subscription prices or consideration allegedly owed and unpaid by each of them to Nazareth for the outstanding shares of record. In fact, the Debtor objected to allowance

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[103] Pa. Bus. Corp. L. § 605 (*supra*, n. 97).

[104] *Penn-Allen Broadcasting Co. v. Taylor*, 389 Pa. 490, 133 A. 2d 528 (1957, *per* MUSMANNO, *J.*); *Guarantee Title & Trust Co. v. Dilworth Coal Co.*, 235 Pa. 594, 84 A. 516 (1912, *per* BROWN, *J.*).

of all stock-claims, and asked cancellation of all the outstanding Nazareth shares; in the alternative, the Debtor counterclaimed against all 36 stock-claimants for personal judgment for the subscription price of any shares judicially validated, at $1,000 per share (R. 243). The Debtor undertook no proceedings toward forechosure or sale of any of the outstanding stock. For that matter, the Debtor never issued a call; the counterclaims were the first and only notice that subscriptions were unpaid.

Stockholders' liability to the issuer-corporation (or its creditors or their representatives) on unpaid stock subscriptions, is altogether governed by the law of the corporation's domicile.[105] Under Pennsylvania law, the stockholder's *prima facie* case is his stock certificate in regular form. The issuer-corporation bears the *burden of proof*—including the risk of persuasion—of lack of consideration for outstanding shares, and the personal liability therefor owed by the stockholder.[106] "Procedural" matters incident to assessment, if "outcome-determinative" (*e.g.*, statutes of limitation), are part of the "substantive" law of stockholder liability; indeed, they were decisive in bankruptcy proceedings even before *Erie*.[107] Burden of proof is "substantive," too.[108]

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[105] *Harrigan* v. *Bergdoll*, 270 U. S. 560 (1926, *per* BRANDEIS, *J.*); *see* 4 *Collier on Bankruptcy* (14th ed.) ¶ 70.29[2].

[106] *Schmidt* v. *Paul*, 377 Pa. 377, 105 A. 2d 118 (1954, *per* STEARNE, *J.*).

[107] *Harrigan* v. *Bergdoll*, *supra*, n. 105; *see Russell* v. *Todd*, 309 U. S. 280 (1940, *per* STONE, *J.*); *Christopher* v. *Brusselback*, 302 U. S. 500 (1938, *per* STONE, *J.*).

[108] *Cities Serv. Oil Co.* v. *Dunlap*, 308 U. S. 208 (1939, *per* MCREYNOLDS, *J.*) (*diversity*); *Palmer* v. *Hoffman*, 318 U. S. 109, *at* 116 (1943, *per* DOUGLAS, *J.*) (*diversity*); *Garrett* v. *Moore-McCormack Co., Inc.*, 317 U. S. 239 (1942, *per* BLACK, *J.*) (*Jones Act case in state forum*). *See* 1A Moore's Fed. Prac. 2d ed.) ¶ 0.314; 5 *Id.* ¶ 43.08; 3 Collier on Bankruptcy (14th ed.) ¶ 57.13, 57.18[5]; 6 *Id.* ¶ 9.04.

The Debtor proved nothing. Neither Court below placed a valuation on the Market, nor fixed subscription prices, nor ascertained the balances supposedly unpaid by any of the stock-claimants.[109] No shares of stock were validated—only "interests" in Nazareth, and "proportions." (R. 591, 593) The "investments" allowed aggregate $145,987.34 (R. 594-5, 598); additional shares of stock are within the 200-share authorized limit. Ultimately, what the decisions below have found and concluded on the subject, is: "The Market property is sufficient to support a valid stock issue to those entitled thereto." (R. 592)

If Nazareth were insolvent, this record would afford no basis for a money judgment for the benefit of creditors against the aggrieved stock-claimants for unpaid stock subscriptions. Nazareth is solvent; neither does the record afford any basis for a money judgment for the benefit of Nazareth or any of its stockholders against the aggrieved stock-claimants for unpaid stock subscriptions. Mutuality is essential to the stock-subscription contract.[110] Absent ascertained shareholder liability, Nazareth shares cannot be forfeited.

4. Res judicata *bars assessment and stock cancellation.*

(a) The District Court denied the Debtor's counterclaims against all 36 stock-claimants in No. 27000, and, overruling the Debtor's objections to the stock-claims, refused to cancel any Nazareth shares. The Debtor's counterclaims had asked (alternative to cancellation) for assessment of subscription prices against all stock-claimants in the event of judicial

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[109] *See Russell* v. *Todd*, *supra*, n. 107; *Christopher* v. *Brusselback*, *supra*, n. 107; *Harrigan* v. *Bergdoll*, 281 Pa. 186, 126 A. 269 (1926, *per* FRAZER, J.), *aff'd* 270 U. S. 560 (1926, *per* BRANDEIS, J.).

[110] *Penn-Allen Broadcasting Co.* v. *Taylor*, *supra*, n. 104; *see Broderick* v. *Alexander*, 268 N. Y. 306, 197 N. E. 291 (1935, *per* LEHMAN, J.).

validation of any of their respective Nazareth shares (R. 261, 264, 243). So much of the District Court's judgment (denying the Debtor's counterclaims) was *not* appealed from by the Debtor or any other party, nor disturbed by the Court of Appeals. So much of that judgment is now *res judicata*.[111] Assessment, of a liquidated amount due on outstanding shares, is pre-requisite to cancellation or forfeiture of stock. The final judgments below, absent cross-appeal, show *nothing* owed to Nazareth by any of the stock-claimants—including those whose stock-claims were disallowed. Whatever relief the parties may now have, that relief cannot be judicial cancellation of stock.

(b) The Debtor and its stockholders *derivatively* are not "aggrieved parties" in No. 27000.[112] The Debtor's claims to assessment are dead. No money judgment has been rendered against the Debtor in favor of any stock-claimant. The Debtor is not affected by the distribution of its outstanding stock, nor by the identity of its stockholders. The Debtor is a nominal party. No. 27000 is a contest among the stock-claimants themselves.

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[111] *U. S.* v. *American Ry. Exp. Co.*, 265 U. S. 425 (1924, *per* BRANDEIS, *J.*); *Morley Constr. Co.* v. *Maryland Cas. Co.*, 300 U. S. 185 (1937, *per* CARDOZO, *J.*). *See* 7 *Moore's Fed. Prac.* 2d ed. ¶ 72.05. *See also Angel* v. *Bullington*, 330 U. S. 183 (1947, *per* FRANKFURTER, *J.*).

[112] *City of Tampasas* v. *Bell*, 180 U. S. 276 (1901, *per* MCKENNA, *J.*); *U. S. ex rel. La.* v. *Jack*, 244 U. S. 397 (1917, *per* CLARKE, *J.*)

C. The "general federal equity" invoked, and the purchase-money resulting trust impressed, by the Court of Appeals, violate both federal and state rules of decision.

1. *The overissued Nazareth shares are void.*

The Nazareth articles of incorporation authorize a total issue of 200 shares of stock. Any shares issued in excess of 200, are void. This is an absolute mandate of Pennsylvania law.[115] There is little authority for express ratification by stockholders,[116] and none for estoppel.

Here, the Debtor's outstanding stock of at least 262 shares must be judicially reduced to no more than 200 shares. That is what No. 27000 is all about—and bankruptcy has nothing to do with it.

(a) The overissue is identified by the court as a matter of fact, by an arithmetical or mechanical cut-off at the limit of the number of authorized shares; the overissue is then voided as a matter of law. The law on overissue, largely judge-made, developed mostly in the late 1800s, prior to

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[115] *Jutte* v. *Hutchinson*, 189 Pa. 218, 42 A. 123 (1899), *per* DEAN, *J.*; Mt. Holly Paper Co.'s *Appeal*, 99 Pa. 513 (1882), *per*, SHARSWOOD, *C. J.*; Wright's *Appeal*, 99 Pa. 425 (1882), *per* PAXON, *J.*; *Now codified by* 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 8-104; P. L. 3, § 8-104 (1953, *eff.* 7/1/54), *amended* P. L. 1023, § 8 (1959). *See* U. C. C. *Comment* thereto: "1. The universally recognized prohibition against overissue is here adopted * * *." *See also* Pa. Const., Art. XVI, § 7 (1874, 1956).

[116] *But see* Jeanes' *Appeal*, 116 Pa. 573 (1887), *per* GREEN, *J.*; Kisterbock's *Appeal*, 127 Pa. 601, 18 A. 381 (1889), *per* GREEN, *J.*; *Willis* v. *Phila. & Darby R. R.*, 13 Phila. 33, 6 W. N. C. 461 (C. P. Phila., 1879), *per* HARE, *P. J.*; *New York & N. H. R. R.* v. *Schuyler*, 34 N. Y. 30, *at* 55-6 (1865), *per* DAVIS, *J.* *See also* Pa. Bus. Corp. L. § 320(a); 15 Purdon's Pa. Stats. Ann. § 2852-320(a); P. L. 364, Art. III, § 320 (1933), *added* P. L. 698, § 1 (1939), *amended* P. L. 711, § 1 (1957).

enactment of the Uniform Stock Transfer Act ("USTA") in Pennsylvania in 1911 [117] and in New York in 1913.[118] The cases indicate that the corporate books determined "title" to shares, and thereby the identification of the overissue. No cases have been found where the holder of an overissue sued the holder of valid shares, claiming superior equities: the issuer-corporation seems always to have been the adversary. Now USTA establishes title to stock by ownership of the certificates, not by the corporate books.[119] The rights of the stock-claimants *vis-a-vis* Nazareth are not necessarily the same as their rights *inter se*.

(b) In the usual situation (as in *Nazareth*), the culprit responsible for the overissue is a corporate agent; he, not the corporation, has collected the defrauded holder's price (on a sale) or loan (on a pledge); at the time of exposure, the culprit is judgment-proof. If the culprit had been a stockholder himself, his capital account would have been charged with the shares he sold, *pro tanto*, on a first-in-first-out basis, to the extent of his own valid shares, determined according to the "perfection" of legal title to the shares on the corporate books.[120] When his own shares were exhausted, the culprit was simply selling what he did not own.

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[117] 15 Purdon's Pa. Stats. Ann. §§ 301 *et seq.*; P. L. 126, §§ 1 *et seq.* (1911, *eff.* 1/1/12) (*repealed* 1954).

[118] N. Y. Pers. Prop. L. (40 McKinney's N. Y. Consol. L.) §§ 162 *et seq.* (*eff.* 9/1/13); L. 1913, c. 600; *renumbered by* L. 1939, c. 76, § 4.

[119] *Soltz* v. *Exhibitors Svc. Co.*, 334 Pa. 211, at 215, 5 A. 2d 899 (1939, *per* LINN, *J.*).

[120] *See, e.g., New York & N. H. R. R.* v. *Schuyler*, 34 N. Y. 30 (1865, *per* DAVIS, *J.*); *Moores* v. *Citizens Nat. Bank*, 111 U. S. 156 (1884, *per* GRAY, *J.*).

and what he had no authority to sell for his corporate principal.

To shift his loss, the holder of the void overissue turns to the culprit's principal, the issuer-corporation. The holder's remedy cannot be validation of the void overissue, nor restitution of a purchase price or loan which the corporation never received. So the holder seeks damages. He claims a better title to the stock than the seller-culprit's title, because negotiation of the stock certificate cut off equities and defenses against the culprit, and/or because the corporation is estopped from asserting the invalidity of the overissued shares (as to liability, not the remedy). The estoppel depends on the faithless agent's *apparent* authority to issue or sell the overissued stock, and the corporation's negligence in sanctioning that appearance. (There can be no *actual* authority to overissue stock.)

All this is essentially the law of principal-and-agent. The cause of action by the holder of a void overissue, is substantially the same as the cause of action *for damages* by a holder of shares void for lack of consideration to the issuer-corporation. In either case, where the issuer-corporation did not in fact receive consideration for the shares (or any other benefit), and where the defrauded holder seeks damages, the holder's proof of negligence or estoppel as against the corporation requires much more than mere proof of payment to the agent. The principles of law were stated and applied years ago in a line of classic cases on the subject, decided in Pennsylvania and in other jurisdictions with

similar law.[121] Instructive, too, is a cognate line of cases where corporations (or creditors of insolvent corporations) sued to collect stock subscription prices, and met the defense that the shares were void for overissue or lack of consideration, and therefore not assessable.[122]

Without expatiating on the niceties, the following elementary principles are dispositive in *Nazareth*:

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[121] *People's Bank* v. *Kurtz*, 99 Pa. 344 (1882, *per* SHARSWOOD, C. J.); Wright's *Appeal*, 99 Pa. 425 (1882, *per* PAXON, J.); Mt. Holly Paper Co.'s *Appeal*, 99 Pa. 513 (1882, *per* SHARSWOOD, C. J.); Jeanes' *Appeal*, 116 Pa. 573 (1887, *per* GREEN, J.); Kisterbock's *Appeal*, 127 Pa. 601, 18 A. 381 (1889, *per* GREEN, J.); *Dollar Savings Fund & Tr. Co.* v. *Pittsburgh Plate Glass Co.*, 213 Pa. 307, 62 A. 916 (1906, *p.c.*); *Bonini* v. *Family Theatre Corp.*, 327 Pa. 273, 194 A. 498 (1937, *per* MAXEY, J.); *New York & N. H. R. R.* v. *Schuyler*, 34 N. Y. 30 (1865, *per* DAVIS, J.); *Titus* v. *Great Western Tnpk. Rd.*, 61 N. Y. 237 (1874, *per* LOTT, Ch. C.); *Fifth Ave. Bank* v. *42d St. & Grand St. Ferry R. R. Co.*, 137 N. Y. 231, 33 N. E. 378 (1893, *per* MAYNARD, J.); *Manhattan L. Ins. Co.* v. *42d St. & Grand St. Ferry R. R. Co.*, 139 N. Y. 146, 34 N. E. 776 (1893, *per* MAYNARD, J.); *Hellman* v. *42d St. & Grand St. Ferry R. R. Co.*, 74 Hun 529, 26 N. Y. S. 553 (1st Dept., 1893, *per* VAN BRUNT, P. J.), *aff'd* 148 N. Y. 727, 42 N. E. 723 (1895, *p.c.*); *Mutual L. Ins. Co.* v. *42d St. & Grand St. Ferry R. R. Co.*, 74 Hun 505, 26 N. Y. S. 545 (1st Dept., 1893, *per* VAN BRUNT, P. J.); *Knox* v. *Eden Musee American Co., Ltd.*, 148 N. Y. 441, 92 N. E. 988 (1896, *per* ANDREWS, C. J.); *Jarvis* v. *Manhattan Beach Co.*, 148 N. Y. 652, 43 N. E. 68 (1896, *per* O'BRIEN, J.); *Hudson Tr. Co.* v. *American Linseed Co.*, 232 N. Y. 350, 134 N. E. 178 (1922, *per* HOGAN, J.); *Ehrich* v. *Guaranty Tr. Co.*, 194 A. D. 658, 186 N. Y. S. 103 (1st Dept., 1921, *per* SMITH, J.), *aff'd* 222 N. Y. 673, 119 N. E. 1036 (1922, *p.c.*); *Allen* v. *So. Boston R. Co.*, 150 Mass. 220, 22 N. E. 917 (1889, *per* FIELD, J.); *Craft* v. *So. Boston R. Co.*, 150 Mass. 200, 207, 22 N. E. 917 (1889, *per* FIELD, J.); *Farrington* v. *So. Boston R. Co.*, 150 Mass. 406, 23 N. E. 109 (1890, *per* FIELD, J.); *Smith* v. *Worcester & Southbridge St. Ry. Co.*, 224 Mass. 564, 113 N. E. 462 (1916, *per* LORING, J.); *Moores* v. *Citizens' Nat. Bank*, 111 U. S. 156 (1884, *per* GRAY, J.).

[122] *E.g.*, *Chubb* v. *Upton*, 95 U. S. 665 (1877, *per* HUNT, J.); *Pullman* v. *Upton*, 96 U. S. 328 (1878, *per* STRONG, J.); *Scoville* v. *Thayer*, 105 U. S. 143 (1881, *per* WOODS, J.); *Handley* v. *Stutz*, 139 U. S. 417 (1891, *per* BROWN, J.). *See* 4 Collier on Bankruptcy (14th ed.) ¶ 70.29[2].

> "* * * an agent cannot bind his principal, even in matters touching his agency, where he is known to be acting for himself, or to have an adverse interest. [Cases cited.]
>
> "The plaintiff in such a case assumes the risk of the agent's disloyalty to his trust, and has no occasion for surprise when he discovers that the agent has served himself more faithfully than his principal." [123]

If the defrauder is the purchaser's own agent *in that transaction*, the agent's knowledge of prior equities will be imputed to the purchaser-principal.[124]

(c) Most or all of the 36 stock-claimants in No. 27000 have not made, and cannot make, proof of estoppel or negligence *vis-à-vis* Nazareth.

In dealing in the Nazareth stock, Malakoff openly professed to own all the stock himself, and to be the managing agent of the issuer-corporation. Until delivery of the stock certificates, most of the stock-claimants held, as *quid pro quo* for their advances, nothing but Malakoff's letter-receipts, most of which stated:

> "* * * all of the authorized stock * * * has been issued to me. * * * I may cause to be issued to you *n* shares of my present stockholdings. * * * the method of operation is to remain solely in my hands. * * *" (R. 186-7)

Malakoff's letter-receipts, by making full disclosure of his self-dealing in the Nazareth stock, conclusively put the

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[123] *Manhattan L. Ins. Co.* v. *42d St. & Grand St. Ferry R. R. Co.*, 139 N. Y. 146, *at* 151-2, 34 N. E. 776 (1893, *per* MAYNARD, *J.*).

[124] *Curtis, Collins, & Holbrook Co.* v. *U. S.*, 262 U. S. 215 (1923, *per* TAFT, *C. J.*) (quoted *at* pp. 87-88, *supra*); *Munroe* v. *Harriman*, 85 F. 2d 493 (2d Cir., 1936, *per* SWAN, *J.*), *cert. den.* 299 U. S. 601 (1936); *Holden* v. *N. Y. & Erie Bank*, 72 N. Y. 286 (1878, *per* FOLGER, *J.*); *Scouton* v. *Stony Brook Lumber Co.*, 261 Pa. 241, 104 A. 548 (1918, *per* WALLING, *J.*).

stock-claimants "on notice."[125] Those writings bind the stock-claimants as against Nazareth, irrespective of any fraud committed by Malakoff *qua* agent of Nazareth.[126] Near the end, stock certificates delivered to a handful of investors contemporaneously with their payments to Malakoff, appeared as if original issues; Malakoff had not first negotiated to those purchasers stock certificates in his name and ostensibly genuine. Those stock-claimants, too, were paying and trusting Malakoff individually, and were legally "on notice."[127] The stock-claimants could acquire no better title than Malakoff's to stock which Malakoff took *illegally* from Nazareth in his own name and transferred.

Neither could those stock-claimants prevail on the contention that they had undertaken to buy an original issue from Nazareth, and that they had dealt with Malakoff *qua* agent, not individually. Every stock-claimant paid Malakoff—not Nazareth—for his stock. Payment for an original issue should have gone to Nazareth.[128] Ultimately, what distinguishes *Nazareth* from *all* the other reported cases on fraudulent stock issues, is the absence of stock certificates upon which the stock-claimants could stake their putative reliance on Malakoff's misrepresentations of authority and genuineness.[129] Without stock certificates, most of the stock-

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[125] *Northridge Co-op. Sec. No. 1, Inc.* v. *32nd Ave. Constr. Corp.*, 2 N. Y. 2d 514, *at* 527-8, 161 N. Y. S. 2d 404 (1957, *per* VAN VOORHIS, *J.*); *Danann Realty Corp.* v. *Harris*, 5 N. Y. 2d 317, 184 N. Y. S. 2d 599 (1959, *per* BURKE, *J.*); *Ernst, Iron Works, Inc.* v. *Duralith Corp.*, 270 N. Y. 165, 200 N. E. 683 (1936, *per* FINCH, *J.*).

[126] *Wittenberg* v. *Robinov*, 9 N. Y. 2d 261, 213 N. Y. S. 2d 430 (1961, *per* FROESSEL, *J.*).

[127] *Moores* v. *Citizens' Nat. Bank*, 111 U. S. 156 (1884, *per* GRAY, *J.*).

[128] *See Fehr* v. *Campbell*, 288 Pa. 549, 137 A. 113 (1927, *per* MOSCHZISKER, *C. J.*); *Hartzell* v. *Ebbvale Mining Co.*, 239 Pa. 602, 86 A. 1093 (1913, *per* ELKIN, *J.*); *Martin* v. *Inter-State Lumber Co.*, 263 Pa. 248, 103 A. 613 (1918, *p.c.*).

[129] *Cf. cases cited supra*, n. 121. *Compare Baldwin* v. *Childs*, 249 N. Y. 212, 163 N. E. 737 (1928, *per* CARDOZO, *C. J.*) *with Barnard* v. *Campbell*, 55 N. Y. 456, *rearg.* 58 N. Y. 73 (1874, *per* ALLEN, *J.*) (*bills of lading*).

claimants here have nothing to rely on, as to Nazareth's liability for Malakoff's over-sales.

(d) Assuming (*arguendo*) that any of the stock-claimants in No. 27000 could sustain a claim of estoppel or negligence as against Nazareth with respect to purchase of an overissue: If successful, they would be entitled to damages in the amount of their purchase prices or loans advanced to Malakoff, though the Debtor might be ordered to go into the open market to buy other valid stock, if "reasonably available for purchase", to substitute for the void overissue in innocent hands.[130]

This law on overissue, and particularly the restricted remedy of the defrauded holder entitled to shift his loss to the issuer-corporation, offers a peculiar protection to the earlier investors or stockholders. Unissued stock is not a corporate asset. The issuance of new stock without consideration to the issuer-corporation, whether or not an overissue, does not, *per se*, affect the corporation's assets or liabilities. On the corporate balance sheet, only the capital account is affected; but the net worth is unchanged. The primary wrong in a fraudulent stock issuance, is the over-division and *dilution* of the stockholders' proportionate interests in the corporation's net worth and control, without fair contribution to the corporation by the latecomers. The stockholders of the solvent corporation are injured *directly*; the corporation as an entity, and the stockholders *derivatively*, suffer no wrong.[131]

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[130] 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 8-104; P. L. 3, § 8-104 (1953, *eff.* 7/1/54), *as amended*, P. L. 1023, § 8 (1959). *See Prince* v. *Childs Co.*, 23 F. 2d 605, at 608 (2d Cir., 1928, *per* A. N. HAND, *J.*).

[131] *Christensen* v. *Eno*, 106 N. Y. 97, 12 N. E. 648 (1887, *per* ANDREWS, *J.*); *Frank Gilbert Paper Co.* v. *Prankard*, 204 A. D. 83, 198 N. Y. S. 25 (3d Dept., 1923, *per* VAN KIRK, *J.*); *Kimmel Sales Corp.* v. *Lauster*, 167 M. 514, 4 N. Y. S. 2d 88 (Sup., Monroe, 1938, *per* VAN VOORHIS, *J.*).

If an insider commits a fraud by selling an overissue for which the corporation—and the stockholders derivatively—are vicariously liable in damages, the absolute invalidation of an overissue effectually gives those stockholders the option to pay money damages out of the corporation, and thereby to avoid dilution of their stock interests. In a rising market (as here), this enhances the valid shares, and may be a poor return to the defrauded holder—notwithstanding that (as here) the earlier investors could not themselves have sustained such an estoppel as against their corporation, and notwithstanding that those earlier investors (derivatively) were themselves negligent as against the innocent latecomers.

(e) To the District Judge and the Examiner, application of the law on overissue seemed arbitrary and inequitable. They avoided such application by the simple omission of certain crucial findings of fact: no findings were made as to *constructive notice* of Malakoff's wrongdoing, and no findings were made as to *identification of the overissue*. The Examiner stated affirmatively that such identification was impossible:

> "143. To hold any of the shares claimed by the claimants-stockholders herein void on account of over-issuance, however, this Court must determine whose shares were and are the over-issued shares. The fact is that no rational or just basis appears in the record for any such determination. * * * The order in which Malakoff made out certificates to the investors and the numbers assigned to the certificates, as well as the dates when he issued such certificates, were purely fortuitous or arbitrary. * * *" (R. 210)

That finding, implicitly adopted by the District Judge, is not "clearly erroneous,"[132] and has not been disturbed

[132] Rule 52(a), Fed. Rules of Civ. Proc., *f.* 28 U. S. C. § 2072

by the Court of Appeals, nor challenged by any of the parties. It is supported by the lack of correlation between the times of the stockholders' advances to Malakoff, the times of Malakoff's promises of "shares" to the stock-claimants, and the dates and numbers on the stock certificates (R. 210-211). Moreover, the Margolis Group, in No. 26962, claims 51 shares, represented by stock certificates scattered among the certificates for the 262 shares claimed by the 36 stock-claimants in No. 27000. Absent consolidation of all 41 stock-claims, no definitive identification of the overissue could possibly be made.

(f) The foregoing left the Courts below with these problems (*inter alia*):

(i) The Nazareth shares had to be judicially reduced to no more than 200 total. Both Courts below could not—and would not—eliminate the overissue by arithmetic alone.

(ii) A reduction of Nazareth shares *below* 200 total, necessarily would rest on a ground other than overissue; for the overissue left 200 shares presumptively valid. The only other ground for voiding corporate shares was lack of consideration to the issuer-corporation. However, assessment of the subscription price (the Debtor's alternative counter-claim against the stock-claimants) would not resolve the overissue.

(iii) All the stock-claimants, *vis-à-vis* Nazareth, were on notice of the infirmities in Malakoff's title to stock, and were no more "good-faith purchasers" than the few who had not advanced contemporaneous consideration to Malakoff. Therefore, any classification of stock-claimants necessarily would depend on a legal ground other than the relative positions of the stock-claimants *vis-à-vis* Nazareth.

2. *The purchase-money resulting trust impressed by the Court of Appeals is barred by applicable state rules of decision.*

Having cancelled all the outstanding Nazareth stock (despite the Pennsylvania law), the Court of Appeals then impressed a purchase-money resulting trust. What had begun as a distribution of the *Debtor's stock* in a reorganization of the Debtor, finished as a distribution of *Malakoff's assets* without Malakoff. Judge Moore wrote:

> "* * * The sellers (Philadelphia group) have been paid for that [Market] property by Malakoff. Malakoff in turn obtained the money *for this purpose* from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a *trustee*, fiduciary, *agent*, promoter or syndicator (the terminology is unimportant—the facts create the rights) *for those who gave him their funds for investment in the project.* They should in equity receive that for which they paid." (R. 592-3; *emphasis supplied.*)

Applicable state law bars such a remedy. The rules of decision in equity in both New York and Pennsylvania, preclude the resulting trust impressed below, irrespective of "terminology."

(a) In *New York*, the purchase-money resulting trust has been explicitly abolished by statute,[133] incident to a codification of the law of trusts.[134]

The resulting trust, as a form or device, has been found dispensable. It served either to presume intent or to avoid and remedy fraud. Those purposes are served by the trusts that remain in New York: the *express trust*, subject to the

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[133] N. Y. Real Prop. L. (L. 1909, c. 52) (49 McKinney's N. Y. Consol. L.) § 94.

[134] N. Y. Real Prop. L. § 91 (*supra*, n. 133).

statute of frauds; and the *constructive trust*, or judicially "implied" or "fraud-rectifying" trust.[135]

An express trust or a constructive trust in *Nazareth* would have allowed the prevailing stock-claimants *precisely* "that for which they paid" (R. 593) — *e.g.*, in Weinstein's case, $^{7}/_{200}$, or 3.5%, under his letter-receipt from Malakoff, instead of 4.79% as awarded to him by the Court of Appeals.

(b) In *Pennsylvania*, resulting trusts, though not abolished, have been severely curtailed by statute and case-law. A purchase-money resulting trust could operate here in favor of an "investor" *only* if his advances had been made to Malakoff *before* Malakoff had paid the purchase price of the realty to the Philadelphia Group. *Subsequent* advances, even if used for improvement of the realty or for satisfaction of liens on the realty, would at most give the "investor" an equitable lien for recovery of his "investment" but *not* equitable ownership of the realty.[136]

Musselman v. Myers,[137] decided by the Pennsylvania Supreme Court in 1913, is particularly apposite to *Nazareth*.

> "* * * about February 22d, 1911, [plaintiff] agreed with * * * Myers * * * to subscribe the sum of $2,500 to the capital stock of a proposed corporation, which was about to be formed with a capital of $20,000 for the purpose of purchasing the real estate * * *; that

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[135] *Fraze Realty Co., Inc.* v. *Natanson*, 261 N. Y. 396, 185 N. E. 679 (1933, *per* KELLOGG, *J.*); *In re* Cohen's Estate, 137 N. Y. S. 2d 300 (Sup., N. Y., 1954, *per* WALTER, *J.*), *aff'd* 285 A. D. 1119, 141 N. Y. S. 2d 819 (1st Dept., 1955), *aff'd* 309 N. Y. 935, 132 N. E. 2d 311 (1955).

[136] *Musselman* v. *Myers*, 240 Pa. 5, 87 A. 425 (1913, *per* ?); *Farmers Trust Co.* v. *Bevis*, 331 Pa. 89, 200 A. 54 (1938, *per* DREW, *J.*); *Majors* v. *Majors*, 349 Pa. 334, 37 A. 2d 528 (1944, *per* HUGHES, *J.*); *Accord: Olcott* v. *Bynum*, 84 U. S. 44 (1873, *per* SWAYNE, *J.*).

[137] *Supra*, n. 136.

on February 24th, 1911, at the direction of Myers, plaintiff paid the amount of his said subscription to * * * Sherwood as the agent and for the account of Myers; that at the said time Myers was under agreement with * * * the owners of record of the said land, for the purchase thereof, and had paid them on account of said purchase about the sum of $500; that the purchase price named in the said agreement was $9,600; that Myers completed the purchase of the land on March 3d, 1911, by paying to the [owners] the further sum of $2,700 (which included the sum of $2,500 received from the plaintiff) and having executed * * * a purchase money mortgage for $6,400; * * *.

"* * * It appears, therefore, that Myers had acquired an equitable interest in the land before the receipt of the plaintiff's money, and that the said subscription was employed only in making a subsequent payment on account of the price. No resulting trust could arise in favor of the plaintiff under these circumstances.

"'A resulting trust is raised only from fraud in obtaining the title, or from payment of the purchase money when the title is acquired. Payment of the purchase money subsequently is not sufficient to raise a legal implication of a trust as all the authorities show.': [Pa. cases cited.]

"The amount of the plaintiff's subscription was not in the hands of Myers at the time he acquired his inceptive equitable interest in the land, which was the inception of the title to it, by the payment of the $500 hand money, nor does it appear * * * that at that time Myers expected to receive it and relied upon it for funds with which to make the additional cash payments which he afterward made upon the account of the purchase price." * * *

> "The plaintiff appears to be entitled to have the stock for which he subscribed or the return of his money. We think that his remedy is a suit at law. * * *" [138]

In *Nazareth*, Malakoff is said to have paid the Philadelphia Group a total of $77,010.81, and to have received a total of $79,025 from "investors", all *before* February 15, 1952 (R. 589). Yet, "investments" aggregating $145,987.34 —almost half advanced *after* that date—have been allowed (R. 594-5, 598). Under Pennsylvania law, those later "investors" *cannot* be *cestuis* of a purchase-money resulting trust. Indeed, neither could most of the "investments" made *before* February 15, 1952, qualify for a resulting-trust interest. Malakoff had a ¼ interest in the Market from the time of its purchase by the Philadelphia Group in March and April of 1951. He had advanced $17,489 to them not later than May 8, 1951, and, through them, at least $12,489 to the sellers of the Market. Of that $17,489, $8,000 had been advanced by Kanter, Samet, and G. S. Klein; Malakoff promised them participating "shares" in Malakoff's "interest" in the venture, and their $8,000 has been traced by explicit findings. In July of 1951, Malakoff contracted with the Philadelphia Group to buy—and he then acquired an *equitable* interest in—the *entire* Market property. No "investments" by other stock-claimants were found to have been made until August of 1951 and thereafter; nor is there any evidence or finding that any of the prevailing stock-claimants, other than Kanter, Samet, and G. S. Klein, had any relationship with Malakoff before or during July of 1951 to establish Malakoff's "reliance" on them for the balance of the price he owed to the Philadelphia Group (R. 588-9, 230-1, 51-2, 56-7). The impression of a purchase-money resulting trust here would leave Kanter, Samet, and G. S. Klein (the April "investors") as the sole *owners* of the Market.

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[138] *Musselman v. Myers*, *supra*, n. 136, 240 Pa. *at* 6-9.

Neither can the later "investors" qualify as "good-faith purchasers" to perfect an equitable interest in the Market *vis-à-vis* prior *cestuis* of the purchase-money resulting trust.[139] In purchasing the Market, Malakoff is now said to have acted (as agent or trustee) for *all* the "investors" *in the purchase transactions*, and not for himself, for Nazareth, or for the sellers (R. 592-3). Therefore, the later "investors" (certainly those who made their advances to Malakoff after February 15, 1952) are charged with *notice* of Malakoff's wrongdoing in selling the true *cestuis'* interests in the realty for Malakoff's own benefit; and the later "investors" cannot be "*bona fide* purchasers" *vis-à-vis* those true *cestuis*.[140]

(c) If the Court of Appeals admitted those later "investors" to participation in the Market because Malakoff was their trustee *ex maleficio*, and if those later "investors" thereby obtained the same standing here as the earlier "investors" for whom Malakoff was supposedly a purchase-money resulting trustee, then the Court of Appeals has converted this corporate reorganization into an *in rem* proceeding to distribute Malakoff's property to anyone with any kind of equitable interest therein. The aggrieved stock-claimants (whose stock-claims were disallowed) then have the same standing as those later "investors." For what the Court of Appeals has characterized as "antecedent indebtedness *or other transactions* with [Malakoff] unrelated to the Nazareth venture *as consideration*" (R. 594; *emphasis supplied*), may also have been trust funds in Malakoff's hands, and may also have raised equitable interests in the Market in their favor. (*See, e.g.*, as to the Dancigers' consideration, R. 595, 148-9.) The Court of Appeals has not distinguished between true

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[139] 21 Purdon's Pa. Stats. Ann. § 601; P. L. 425, § 1 (1901).

[140] *Curtis, Collins, & Holbrook Co.* v. *U. S.*, 262 U. S. 215 (1923, *per* TAFT, C. J.) (*quoted at* pp. 87-88, *supra*); *Munroe* v. *Harriman*, 85 F. 2d 493 (2d Cir., 1936, *per* SWAN, J.), *cert. den.* 299 U. S. 601 (1936); *Holden* v. *N. Y. & Erie Bank*, 72 N. Y. 286 (1878, *per* FOLGER, J.); *Scouton* v. *Stony Brook Lumber Co.*, 261 Pa. 241, 104 A. 548 (1918, *per* WALLING, J.).

"indebtedness" and "trust funds" with respect to the aggrieved stock-claimants; and all semblance of "tracing" and "notice" has been abandoned as to the later "investors." Indeed, the Court of Appeals' theory would entitle Malakoff's creditors and *cestuis at large* to the same opportunity as the later "investors" here to prove equitable interests in the Nazareth Market.[141]

Thus, the peculiar resulting trust impressed below—advocated by Weinstein and Fried in their joint briefs below, and barred by both New York and Pennsylvania law—is the sole "equitable" device which can penalize 6 stock-claimants, while enriching 30 others, for Malakoff's individual wrongdoing—of which all 36 have been found equally innocent.

3. *The classification of stock-claimants by the Court of Appeals, is arbitrary and unreasonable in terms and in application, and depends upon the prohibited setting aside of District Court findings of fact not "clearly erroneous."*

The major errors committed by the Court of Appeals in No. 27000, and relating to the Question Presented to this Court, have been discussed above. Of the many additional errors below, a few require notation to demonstrate the need for complete reversal of the Court of Appeals' decision, and complete rejection of its rationale.

(a) *Unreasonable classification:* The Court of Appeals decided the stock-claims by classifying all 36 stock-claimants in No. 27000 into two categories, and then excluding some of them from participation in Nazareth stock. The classification is unreasonable on its face, and is arbitrary in its application to the particular stock-claimants.

> "As to the stock claimants, with few exceptions they fall into two distinct categories: (1) those investors who paid for a participation in the Nazareth Market by cash, check or *credit*, and (2) those who

[141] *See generally* 4 *Collier on Bankruptcy* (14 ed.) ¶¶ 70.25, 70.41.

> did not make any payment but who rely upon *antecedent indebtedness* of Malakoff and other transactions with him unrelated to the Nazareth venture as consideration." (R. 594; *emphasis supplied.*)

This is simply no classification. "Credit" is the correlate of "debt" or "debit"; "credit" must be credit *for* something. "Credit" here is not cash or check. Here, it must mean "credit *for* antecedent indebtedness or investment exchange." It can mean nothing else. This is like saying: Class A contains only odd numbers, and Class B contains only even numbers—but some odd numbers, too. By this system, whim—not reason—dictates whether odd numbers are put into Class A or Class B, and whether stock-claims are put into Class 1 or Class 2.

The Court of Appeals' application of that classification to the particular stock-claims, repeatedly reveals arbitrariness. *E.g.:* The following stock-claimants have been put into the first class ("good"), though some or all of their "consideration" had been found by the District Court to have been moneys *previously* advanced to Malakoff by way of loans or investments, or moneys held by Malakoff as profits or returns of capital on "other transactions with [Malakoff] unrelated to the Nazareth venture": Jerome Fried, $2,000 "profit" (R. 155-6); H. Lawrence Laupheimer, $2,750 investment exchange (R. 116-7); Gertrude Silver Klein, $2,000 loan and $6,000 investment exchange (R. 67-8); Miriam Klein, $2,150 loan and/or investment exchange (R. 98, 100).[142] Those "credits" are no different in kind from (*e.g.*) Kanter's $4,800 investment exchange in September of 1951, which the District Court *found* to be "valuable equities" and to have been part of the "net fair value of the investment" by Kanter. (R. 232; *see* R. 59-60, 63; *cf.* R. 595).

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[142] "As to these claimants, the findings of the Examiner and the trial court relating to the amounts paid to Malakoff *and the circumstances under which they were paid* are affirmed." (R. 594; *emphasis supplied.*)

(b) *Violation of "clearly erroneous" rule:* In order to impress a purchase-money resulting trust on the Market, the Court of Appeals needed two general *facts* as foundation, *viz.: tracing* of the "investors'" advances to Malakoff into the purchase price of the Market,[143] and *intention* of the prevailing stock-claimants to deal with Malakoff as *their agent* or trustee (not as their seller) in the acquisition of "shares" of the Market or Nazareth.[144] The Court of Appeals found those facts, and thereby set aside the District Court's findings, to the contrary, that there had been *no tracing* of any of the stock-claimants' advances to Malakoff (except those of Kanter, Samet, and G. S. Klein in April of 1951), and *no tracing* of the source of Malakoff's payments of the purchase price to the Philadelphia Group, and that *all* 36 stock-claimants in No. 27000 had *intended* to deal with Malakoff in his *individual* capacity as seller of "shares." Similarly, the Court of Appeals traced the source of Malakoff's "dividends," thus setting aside the District Court's findings to the contrary.

The relevant discrepancies in the *nisi prius* findings and the appellate findings on tracing and intention, are documented in Wolf's Statement of Facts (pp. 22-24, *supra*), and need not be repeated here. What does need to be noted is that *tracing* presumptions and fictions, while useful *vis-à-vis* the wrongdoer, have most doubtful "equity" as to the wrongdoer's *victims inter se*.[145] And what does need to be repeated, is Judge Moore's statement recognizing—but avoiding—the gross inconsistencies in findings of fact above and below as to the stock-claimants' *intent* and Malakoff's *capacity*:

> "Although the findings of fact of the Examiner may be accepted almost in their entirety, his conclu-

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[143] *See Cunningham (Trustee of Ponzi) v. Brown*, 265 U. S. 1 (1924, *per* TAFT, *C. J.*); 4 *Collier on Bankruptcy* (14th ed.) ¶¶ 70.25, 70.41. *N. B.* R. 590, n. 1.

[144] *See Majors v. Majors*, 349 Pa. 334, *at* 338-9, 37 A. 2d 528 (1944, *per* HUGHES, *J.*).

[145] *See Cunningham v. Brown*, *supra*, n. 143.

> sions are at variance with the equitable principles applicable here. The Examiner treated *Malakoff as the owner* and operator of the Debtor and *each claimant as having purchased his interest from Malakoff.* This *erroneous assumption* made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory that stock transfers from Malakoff rested upon adequate consideration if the Stock Transfer Acts' definition of 'value' were satisfied. * * * " (R. 53; *emphasis supplied.*)

The Examiner's "treatment" is characterized as an "assumption," and is held "erroneous." But that "assumption" was a finding of fact, or at least rested on underlying and implicit findings of fact as to the many transactions between Malakoff and the 36 stock-claimants in No. 27000. In November of 1961, the Court of Appeals undertook itself, from a cold record, to make 36 findings of fact as to the state of mind of each of 36 persons at various times during a two-year period from March of 1951 to April of 1953, who were dealing with a man (Malakoff) who died in 1955. The District Court had spent 86 days of actual trial in 1958 and 1959—then already five years and more after the events—listening to and looking at more than 50 witnesses (including nearly every stock-claimant), whose aggregate testimony fills almost 10,000 pages of minutes, and who introduced literally hundreds of pages of documentary evidence. Both the District Judge and the Examiner had then *independently* engaged in "pains-taking" review of the evidence, reflected in a 236-page Report by the Examiner and in findings and conclusions by the Judge (R. 590; 492, 245-6). Every shred of documentary evidence—the stock-claimants' checks to Malakoff, the letter-receipts from Malakoff, the dividends from Malakoff, etc.—showed the clear understanding and agreement between Malakoff and every stock-claimant (except Kanter, Gertrude Klein, and Samet) that every stock-claim-

ant of the 36 was buying *stock* Malakoff professed to own himself. The only evidence to the contrary consists of the self-serving testimony of some of the 36 stock-claimants as to their putative conversations with the dead John Malakoff more than five years earlier—evidence of *no* probative value. (*See, e.g.*, the evidence in Weinstein's case, pp. 24-25, *supra*.)

On appeal, the facts of the case are established by the findings of the trial court "unless clearly erroneous":

> "[Rule 52](a) * * * Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. * * * " [146]

This Court crystallized the apposite principles a generation ago.

> "Findings as to the *design, motive and intent* by which men act depend peculiarly upon the credit given to witnesses by those who see and hear them. If defendants' witnesses spoke the truth, the findings are admittedly justified. * * * While, of course, it would be our duty to correct clear error, even in findings of fact, the Government has failed to establish any greater grievance here than it might have in any case where the evidence would support a conclusion either way but where the trial court has decided it to weigh more heavily for the defendants. Such a choice between two permissible views of the weight of evidence is not 'clearly erroneous.' " [147]

The District Court's findings were not "clearly erroneous"; indeed, they were the only reasonable findings of fact

[146] Rule 52(a), Fed. Rules of Civ. Proc., *f.* 28 U. S. C. § 2072.
[147] *U. S.* v. *Yellow Cab Co.*, 338 U. S. 338, *at* 341-2 (1949, *per* JACKSON, *J.*) (*emphasis supplied*).

on the evidence. In substituting its own findings of fact, the Court of Appeals has committed an egregious violation of Rule 52(a) and has acted outside the proper scope of appellate review. Thereby, the Court of Appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

D. The Debtor's 200 authorized shares should be distributed among the 36 stock-claimants in direct proportion to their respective record holdings of 262 shares of stock actually issued in 1953. Thereby, all the stock-claimants, equally innocent of Malakoff's wrongful over-sales, will ratably absorb the dilution in their promised interests in Nazareth.

The realities of *Nazareth* show two simple—and decisive—legal factors. First, the relations among Nazareth, Malakoff, and the 36 stock-claimants were truly *tripartite*. Malakoff expressly undertook to sell to the stock-claimants what he had individually acquired from Nazareth, and what he himself owned. Even if he had said something different, his conflicts of interest with Nazareth, and his misrepresentations to and conflicts of interest with the stock-claimants, would still have made him an individual seller with respect to at least some of the stock-claimants, as a matter of law. For he did not act within the scope of his agency or his trust to anyone in over-selling Nazareth stock to the stock-claimants and in causing Nazareth to overissue stock. Secondly, the only relevant *wrong* committed by Malakoff was his over-sale and overissue of Nazareth shares, which diluted all stock-claimants' interests in Nazareth and thus affected them directly, not derivatively. There was no lack of consideration to Nazareth for issuance of 200 shares (the authorized limit); and even if there were, the remedy would be assessment, not cancellation—which would not cure the overissue.

This litigation could never have come to pass if Malakoff had not misrepresented total sales of 200 shares, and if Nazareth were authorized to issue (say) 400 shares of stock. All 36 stock-claimants were equally innocent of participation in Malakoff's wrongdoing, and all (certainly the earlier "investors") were equally supine in abdicating control of Nazareth to Malakoff. All 36 should share ratably in the loss imposed on them all by Malakoff alone.

The District Court's viewing Nazareth as Malakoff's *alter ego* and/or principal in the stock-sales, and the Court of Appeals' viewing Malakoff as the stock-claimants' agent or trustee in the stock-sales, avoided recognition of the tripartite relationship and the critical wrong by Malakoff, and thereby muddied the record below and yielded two decisions vastly different from each other, yet both gravely erroneous in their own terms, in fact and in law.

The only proper resolution of the 36 stock-claims in No. 27000 in accordance with the unassailable findings of fact by the District Court and the applicable Pennsylvania and New York rules of decision—and a perfectly "equitable" resolution of the controversy among the stock-claimants *inter se*—is the distribution of the entire 200 issued and outstanding Nazareth shares within the authorized limit, to all those 36 stock-claimants, in direct proportion to their respective holdings of the 262 outstanding shares of stock which Malakoff caused Nazareth to issue in 1953.

The relief prayed for by Wolf, differs from the District Court's judgment only with respect to the index of participation by the 36 stock-claimants. The number of shares purchased from Malakoff under the stock-purchase contracts—not the amount of moneys advanced to Malakoff therefor—should determine the ratable participation of the 36 stock-claimants in Nazareth.

1. *The rights of the stock-claimants, inter se, to Nazareth shares, are determined by their respective stock-purchase contracts with Malakoff, not by the amounts of their respective "investments."*

(a) What this Court has said about the Constitutional limitations on Congress in the exercise of the bankruptcy power by legislation, applies as well (*mutatis mutandis*) to the Constitutional limitations on the Chapter X courts in the administration of the legislation implementing the bankruptcy power:

> "*Fourth.* The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the States, it is not prohibited from impairing the obligation of contracts. [Cases cited.] But the effect of the [Frazier-Lemke] Act here complained of is not the discharge of Radford's personal obligation. It is the taking of substantive rights in specific property acquired by the Bank prior to the Act. In order to determine whether rights of that nature have been taken, we must ascertain what the mortgagee's rights were before the passage of the Act. We turn, therefore, first to the law of the State." [149]

What is covered by a lien, is a matter of contract between the parties, in accordance with applicable state law. No less than liens on realty, shares of corporate stock are property, and are likewise determined by contract between the parties, in accordance with applicable state law.[150]

(i) The Bankruptcy Act provides for the trustee's *rejection* of otherwise valid *executory* contracts. Thereby, the

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[149] *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, at 589-590 (1935, *per* BRANDEIS, J.).

[150] *Schaad* v. *Hotel Easton Co.*, 369 Pa. 486, 87 A. 2d 227 (1952, *per* STERN, J.).

bankrupt's performance is excused, and is replaced by an obligation to compensate in damages; the damages are limited in amount, and the bankrupt's liability therefor is discharged. Only thus may the bankrupt (or his trustee) substitute money for the *future* transfer of the bankrupt's property promised under a valid contract. More than that, is unconstitutional.[151]

(ii) The Bankruptcy Act provides for the trustee's avoidance of otherwise valid *executed* contracts and *past* transfers of the bankrupt's property if—and only if—the bankrupt's transfer was "preferential," *i.e.* (*inter alia*) if the transfer was "perfected" within four months of bankruptcy while the bankrupt was then insolvent (in the bankruptcy sense) and in consideration of "antecedent indebtedness."[152] Here, the last stock certificate issued by Nazareth to any of the 36 stock-claimants in No. 27000, was delivered to the Dancigers on April 28, 1953 (R. 146, 150)—five months before the reorganization petition was filed (on September 28, 1953). Nazareth was not then insolvent in the bankruptcy sense. (Saul General-Examiner's Exh. BY; R. 516, 518, 9587.) Indeed, there is no finding that Malakoff himself was insolvent before June 17, 1953 (R. 57).

(b) Both Courts below have used the stock-claimants' "investments" (variously defined) as the index of judicial distribution of Nazareth shares to the stock-claimants. The Courts have proceeded as if they were distributing in kind the proceeds of a fund of money in which certain stock-claimants were entitled to share ratably. They have presupposed that all the outstanding Nazareth shares were void, and that a share in the fund depended on a contribution of money to that fund or on a damage claim against the prop-

[151] Bankruptcy Act, § 116(1); 11 U. S. C. § 516(1); 52 Stat. 885 (1938); *see* 6 *Collier on Bankruptcy* (14th ed.) ¶¶ 3.23, 3.24, 3.25. *See also Cohen* v. *East Netherland Holding Co.*, 258 F. 2d 14 (2d Cir., 1958, *per* LUMBARD, *J.*), *aff'g* [*sub nom. In re New York Investors Mutual Group, Inc.*] 153 F. S. 772 (S. D. N. Y., 1957, *per* WEINFELD, *J.*).

[152] *See generally* 3 *Collier on Bankruptcy* (14th ed.) ¶ 6002.

erty of a common debtor: "Greater equity will be achieved by calculating the allowed claims in terms of dollars rather than in invalidly issued shares" (R. 593).

(i) The *Debtor* has no interest in the varying prices paid by the stock-claimants to Malakoff for their respective shares. The Debtor is satisfied by its receipt of the Market for all those shares, and is indifferent to the devolution of its shares—or the prices to successive transferees in the open market—once the over-all subscription price is paid for the original issue. Indeed, there may be good business reasons for the corporation itself to sell its own shares in the market at different prices at different times.[153]

(ii) As to the *stock-claimants inter se:* They have all *affirmed* their stock-purchase contracts with Malakoff, by demanding stock, not money. Some have asked damages or restitution in the alternative, in the event that their stock-claim should be denied, *e.g.*, Weinstein (R. 120-1). No one has attempted to rescind.[154] Malakoff varied his prices to the stock-claimants: *e.g.*, $333 per share to Kanter in April of 1951 (R. 58-9); $600 per share to Katzenell, $667 per share to Fried, and $1,000 per share to Weinstein, all in early September, 1951 (R. 178-9, 157, 123). Malakoff represented himself as an individual seller, and he made no promises or representations to any stock-claimant as to the price of shares he had charged or would charge to other stock-claimants. He was emphatic that the "shares" he sold, in fractions of $n/200$, would fix his purchasers' interests in Nazareth, regardless of the form the venture might take.

> "In the course of my management of the Market, I may cause to be issued to you [illegible]00 shares of my present stockholdings. On the other hand, I may

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[153] *See Maguire* v. *Osborne*, 338 Pa. 121, 130 A. 2d 157 (1957, *per* C. J.); *Atlantic Refining Co.* v. *Hodgman*, 13 F. 2d 781 (3d Cir. [Del.], 1926 *per* BUFFINGTON, J.), *cert. den.* 273 U. S. 731 (1926).

[154] *Cf. Cunningham (Trustee of Ponzi)* v. *Brown*, 265 U. S. 1 (1924, *per* TAFT, C. J.); R. 590, n. 1.

> cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your *a shares* will be applied as your contribution with a corresponding *proportionate interest.* * * * " (R. 187; *emphasis supplied.*)

Assuming (*arguendo*) that the price of Nazareth "shares" had to be equal, *per share*, to all (whatever the ground): The *remedy* for under-payment of the aggregate price is *not* forfeiture of some of the aggregate shares. If the "shareholder" affirms his purchase, the remedy is *assessment* or call of the unpaid portion of the price for all shares he contracted to buy. This is the general law applied to *non*-corporate business associations, *e.g.*, partnerships, joint ventures, syndicates: and it approximates the Pennsylvania law—and remedy—applied to insufficiency of consideration for *corporate* stock subscribed for. The other members of the association might be entitled to rescind their own purchases of "shares," or to dissolve the venture or association; or they (or their creditors) might have a lien on the "shares" not fully paid for; and they might enforce that lien by foreclosure and sale. But forfeiture—disfavored in equity—is barred, absent explicit contract otherwise.[155] The Nazareth stock-claimants have no more *direct* right to redistribution of shares *inter se* in a non-corporate context, based on variation in purchase price of Nazareth "shares," than they have *derivatively* through Nazareth to reduce shares by forfeiture on the ground of non-payment of the subscription price owed to Nazareth for its corporate stock.

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[155] *Patterson* v. *Silliman*, 28 Pa. 304, *at* 313-5 (1857, *per* KNOX, *J.*); *Reiter* v. *Morton*, 96 Pa. 229 (1880, *per* GREEN, *J.*); *Akin* v. *Luce*, 63 Hun 632, 18 N. Y. S. 392 (Gen. T., 1st Dept., 1892, *p. c.*); *Westwood* v. *Grissey*, 139 A. D. 841, 124 N. Y. S. 97 (4th Dept., 1910, *per* SPRING, *J.*). *See Meinhard* v. *Salmon*, 249 N. Y. 458, *at* 469-462, 164 N. E. 545 (1928, *per* CARDOZO, *C. J.*). *See also Tompkins* v. *C. I. R.*, 97 F. 2d 396, *at* 399-400 (4th Cir., 1938, *per* WAY, *D. J.*); 2 *Rowley on Partnership* (2d ed., 1960) §§ 52.26-.28, 52.43.

(c) The "Greater equity * * * achieved by calculating the allowed claims in terms of dollars rather than in invalidly [*sic*] issued shares" (R. 593) is moot at best. Kanter's stock-claim provides dramatic illustration. No one is more aggrieved by the money index than Kanter (or Wolf, his assignee).

The District Court credited Kanter for $8,800 in "capital" invested in Nazareth, comprising $4,000 contemporaneously advanced to Malakoff in April of 1951, plus $4,800 credited in September of 1951 against "antecedent debts" or "investment exchanges." From November 1951 through April 1953, Kanter received $200 per month from Malakoff, aggregating $3,800, and representing a return of 20% per annum on $12,000—not $8,800 (reflecting Malakoff's promise of "shares" in April 1951) (R. 57-63). The District Court deducted that $3,800 in "dividends" from Kanter's "capital" of $8,800, and allowed Kanter $5,000 as the "net fair value of his investment" and his "interest" in Nazareth—*i.e.*, in Nazareth assets, income, and control (R. 232, 241, 262-3).

The Court of Appeals, partly rectifying the disparities in the District Court's index, allowed "interests" in Nazareth according to the entire "capital" initially "invested," without deducting "dividends" as "return of capital." However, the Court of Appeals raised an *in rem* liability on the new Nazareth shares, to secure repayment of those "dividends" out of future "distributions" by Nazareth on those shares (R. 593, 598-9). Thereby, Malakoff's past "dividends" would reduce Kanter's share of future Nazareth income, and perhaps assets on liquidation, but would not reduce shares of control (*i.e.*, votes). The Court of Appeals disallowed Kanter's stock-claim to eight shares, because the $4,800 paid therefor in September 1951 was "antecedent indebtedness to [Malakoff] and other transactions with him unrelated to the Nazareth venture as consideration" (R. 594-5). Kanter's entire $3,800 in "dividends" on the $8,800 would be charged against his new shares. Thus, Kanter would receive an "interest" of $4,000

for his April 1951 "investment" alone, encumbered by a $3,800 "dividend" charge—a net allowance of $200!

By contrast, others who came in at the end (*e.g.*, Tess J. Schwartz, who advanced $3,000 to Malakoff late in March of 1953, through her brother, an early "investor," and who received no "dividends" [R. 130-2, 238, 262-3]) were allowed their full advances as "interests" in Nazareth (R. 262-3, 594-5)—a solvent corporation—in a rising stock-market for Nazareth shares.

(i) As a matter of *fact*, the definitions of "investment" and the treatments of "dividends" by both Courts below, though differing, necessarily depend in common on *tracing those* "dividends" and other payments *by* Malakoff *to* the stock-claimants, as well as tracing payments *to* Malakoff *by* the stock-claimants. But there is no "tracing" of "dividends" in fact. (*See* pp. 25-27, *supra.*) Absent tracing, both definitions of "investment" and both treatments of "dividends" below are erroneous.

(ii) As a matter of *law*, the definitions of "investment" and the treatments of "dividends" by both Courts below, though differing, depend in common on *Malakoff's contracts* with the stock-claimants. If the Courts below are to equate payments *to* Malakoff as payments to Nazareth (or for Nazareth stock) only because of Malakoff's agreement to that effect, and if the Courts below are to equate payments *by* Malakoff as payments by Nazareth only because of Malakoff's earmarking, then the true accounts between *Malakoff* and the stock-claimants (*e.g.*, Kanter) should determine what was "capital" and what was "return of capital" under the reasoning of both Courts below. *A fortiori*, if Malakoff's conduct and contracts are to determine the participation of the stock-claimants in Nazareth stock under the reasoning of both Courts below, the explicit stock-purchase contracts between Malakoff and the stock-claimants—which stated precisely what "shares" the stock-claimants were to receive—should be definitive. There is no "equity" in the Courts below re-writ-

ing those stock-purchase contracts, yet implying different contracts from *Malakoff's* conduct and promises in order to give certain stock-claimants (*e.g.*, Weinstein, a lawyer) a bargain they never made or paid for.

2. *Under applicable state rules of decision, Malakoff's sales of 262 Nazareth shares were legally "present sales" of "when-issued" stock or "future goods." All 36 stock-claimants should share ratably in the limited fungible mass of 200 authorized Nazareth shares eventually issued.*

(a) The law of sales of goods applies to Malakoff's sales of "shares" of Nazareth stock, and determines distribution among the stock-claimants here. The *tripartite* relationship among Malakoff, Nazareth, and the 36 stock-claimants is fundamental, and fact. Irrespective of Malakoff's fiduciary relationship to Nazareth and/or the stock-claimants, he acted as an independent third-party seller in the critical transactions—the sale of Nazareth stock. He purported to sell specific numbers of "shares" which he purported then to own; yet, those "shares" were not then legally owned by Malakoff (except the first 20 during part of the period in issue). He misrepresented, of course, warranting suit against him for damages or the price—an option unexercised by the stock-claimants, and worthless. To the extent that the stock-claimants affirmed their stock-purchase contracts and looked to the "shares," not to Malakoff, they became tenants in common of a mass of stock which Malakoff eventually acquired and was entitled—and required—to appropriate to fulfill his contracts with the stock-claimants. He did "appropriate" the after-acquired property, by the issuance of shares of Nazareth stock to the stock-claimants; and they accepted. To the extent that the recipients of the oversales were not—and could not be—identified, all 36 stock-claimants are similarly situated *inter se* as to their respective rights against the authorized and issued shares, whether 200 or 20 or any other number within the authorized limit. It is as if all 36 stock-claimants had bought their "shares" on the same

day, with identical equities in the fungible mass of Nazareth stock. The corporate overissue (by contrast to Malakoff's oversale) is no more significant than if Malakoff had purported to sell 262 shares of AT&T while he bought only 200.

Shares of corporate stock purchased from a dealer or trader for his own account, are legally fungible goods, like grain, until delivered.[156]

> "* * * under that contract, no title to the stock passed at that time to the plaintiff. The seller did not, at that time, have title to the stock which it agreed to sell, and did not make any contract whereby it undertook to make a present transfer of the property in specific goods. The defendant's contract was a 'contract whereby the seller agrees to transfer the property in goods to the buyer.' [P. P. L.] § 82. The goods were then unascertained. The defendant might thereafter acquire goods of the stipulated description for the purpose of complying with its contract to transfer property in goods of that description to the buyer, but the property in the goods acquired would pass to the buyer only when such goods 'in a deliverable state are unconditionally appropriated to the contract * * * with the assent of the buyer.' P. P. L. § 100, rule 4; [case cited]." [157]

Until the seller's acquisition of title to the goods he has sold, each buyer is an owner in common of a share in the unascertained mass. When the seller does take title,

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[156] *Wills* v. *Investors Bankstocks Corp.*, 257 N. Y. 451, 178 N. E. 755 (1931, *per* LEHMAN, *J.*); *Agar* v. *Orda*, 144 M. 149, 258 N. Y. S. 274 (Sup., N. Y., 1932, *per* SHIENTAG, *J.*), *aff'd* 239 A. D. 827, 264 N. Y. S. 939 (1st Dept., 1933, *p. c.*), *aff'd* 264 N. Y. 248, 190 N. E. 479 (1934, *memo*). In Pennsylvania, too, the sale of corporate stock was governed by the Uniform Sales Act during the years in question (1951-53); *Howell* v. *McCloskey*, 375 Pa. 100, 99 A. 2d 610 (1953, *per* ARNOLD, *J.*); *Cochran* v. *Posey*, 148 Pa. Super. 492 (1942, *per* KENWORTHY, *J.*).

[157] *Wills* v. *Investors Bankstocks Corp.*, *supra*, n. 156, 257 N. Y. *at* 456-7.

he is expected to perform his contracts of future sale, and to deliver in turn to his buyers what he has promised them. Failing the seller's appropriation of the goods to his contracts and delivery to his buyers, each buyer has the right to appropriate his ratable share of the mass, subject to the rights of other owners in common—but each buyer is accountable to the other owners in common for any excess he may appropriate or withdraw for himself. For any undelivered balance, the purchaser has an unsecured claim against the seller for the price or damages.[158]

> "[§ 86] 3. Where the parties purport to effect a *present sale of future goods*, the agreement operates as a contract to sell the goods."
>
> "[§ 87] 1. * * * If the parties intend to effect a present sale [of an undivided share of goods], the *buyer*, by force of the agreement, becomes an *owner in common* with the owner or owners of the remaining shares.
>
> "2. In the case of *fungible goods*, there may be a sale of an undivided share of a specific mass, *though the seller purports to sell and the buyer to buy a definite number*, * * * of the goods in the mass, * * *. By such a sale the buyer becomes owner in common of such a share of the mass as the number * * * bought bears to the number * * * of the mass. * * *"[159]

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[158] N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) §§ 86, 87, 98, 99, 100 (Rule 2), (Rule 4[1]); 69 Purdon's Pa. Stats. Ann. §§ 61, 62, 141, 142, 143 (Rule 2), (Rule 4[1]). P. L. 543 [Uniform Sales Act] §§ 5, 6, 17, 18, 19 (Rule 2), (Rule 4[1]) (1915) (*repealed* 1953). *See Kimberly* v. *Patchin*, 19 N. Y. 330 (1859, *per* COMSTOCK, *J.*); *Conard* v. *Penn R. Co.*, 214 Pa. 98, 63 A. 424 (1906, *per* MESTREZAT, *J.*); 1 *Williston on Sales*, §§ 146-159. *See also U. S.* v. *Raymond [Intermingled Cotton Cases]*, 92 U. S. 651 (1876, *per* WAITE, *C. J.*). *Accord*: 12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code), § 2-105(2), (3), (4); P. L. 3, § 2-105(2), (3), (4) (1953); *see* Pa. Bar Assn. Notes (1)(c), (2), (3); U. C. C. Comment 1 (last par.), 2.

[159] N. Y. P. P. L. §§ 86, 87, *supra*, n. 158 (*emphasis supplied*).

The buyers' rights *inter se* and to the mass, are determined by their respective contracts with the common seller. As with any other sale of goods, consideration for the contract between the dealer and the buyer, if proof is required at all,[160] may be antecedent or future as well as present.[161]

Like principles have been applied, and appropriate results reached, where corporate stock has been over-subscribed (though not actually overissued).[162]

(b) The Court of Appeals, in purporting to "do equity," has disregarded the body of equity jurisprudence evolved over centuries, and has substituted private notions of fairness. Equity displaces legal rights, and replaces legal remedies, only where the chancellor's conscience is shocked by the anticipated result at Law, and only where the petitioner for relief in Equity can prove superior "equities" in the contested title. The federal chancellor is bound both by the judge-made body of Equity he invokes, and by the precedence of apposite—and applicable—Equity under the state law which defines the property rights in issue.

Applicable state rules of decision have erected elaborate safeguards for stockholders, and have provided for the sharing of a fund of after-acquired property, irrespective of misrepresentations by the seller of shares. In those rules of decision is embodied a policy—an Equity—which abhors,

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[160] N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 150(1); 69 Purdon's Pa. Stats. Ann. § 337(1), P. L. 543 [Uniform Sales Act] § 76(1) (1915) (*repealed* 1953). *See also* N. Y. P. P. L. (40 McKinney's N. Y. Consol. L.) § 33(3); L. 1941, c. 331, § 3, *amended* L. 1943, c. 5; L. 1944, c. 588, § 5.

[161] N. Y. Pers. Prop. L. (40 McKinney's N. Y. Consol. L.) §§ 33(1), 33(4); L. 1934, c. 142; *subd. 3 added by* L. 1941, c. 331, § 3; *amended by* L. 1943, c. 5; L. 1944, c. 588, § 5. *See also Sea Modes, Inc.* v. *Cohen*, 309 N. Y. 1, 127 N. E. 2d 723 (1955, *per* DESMOND, *J.*) (*account stated*).

[162] *Lathrop* v. *Knceland*, 46 Barb. [N. Y.] 432 (Gen. Term, 1866, *per* WELLES, *P. J.*, JOHNSON, SMITH, *JJ.*) [*Pa. corp.*]; *Buffalo & N. Y. C. R. R. Co.* v. *Dudley*, 14 N. Y. 336 (1856, *per* JOHNSON, SELDES, *JJ.*).

and avoids, secret liens and forfeitures. The "legal" remedies permit participation in Nazareth stock by all stock-claimants—all equally innocent of wrongdoing—rather than exclusion of a few. If those rules and remedies lack the greater appeal to conscience, if they fail to please, they scarcely shock or appall.

If, nevertheless, Law must yield to Equity here, then that Equity embraces its own rules to ascertain "reliance" and to impute "notice," in order to determine equities and priorities of ownership. By the Court of Appeals' own construct of the resulting trust, Equity conclusively imputes such "notice"—Malakoff's knowledge of other transfers—to his principals or *cestuis*, who can cut off no earlier equities, however deficient as against third parties. The *bona fide* purchaser in equity has, for centuries, been the buyer "for value" *and* "without notice." If these hoary principles apply, they should apply whole. Equity is equal treatment to litigants equally situated.

It is not mere inconsistency below in the invocation and application of Equity, that occasions review here. The Court of Appeals labored to apply medieval principles that still operate ideally *vis-à-vis* the wrongdoer, and among persons some or all of whom enjoyed confidential relations with the wrongdoer. Too often, Equity operates by a chronological mechanics and with an all-or-nothing result, notwithstanding provision for contribution and marshalling. Much of Equity, judge-made, clings to the protection of the principal against the agent's fraud, and the protection of the title vested earliest; a heavy burden falls on the would-be good-faith purchaser. Meanwhile, the Law has marched into the 20th Century with codifications—not only the procedural mergers of Law and Equity, but the uniform acts, and now the Code. The Law begins, slowly and fitfully, to favor the good-faith purchaser over the owner whose absconded agent had usurped authority or title. "Notice" is less technically imputed; "antecedent indebtedness" is good consideration.

The *forms* of *paper* exchanged become less decisive. Exacting scrutiny is not "commercially reasonable" in the market; a creditor's acceptance of payment in kind, and his forbearance from pursuit of his debtor while his debtor slides into insolvency, cast doubt on the wisdom of requiring contemporaneous consideration to support a good-faith purchase.[163]

Decision in No. 27000 should be corollary to *Erie*: federal forum-shopping is irrelevant to substantive adjudication. Decision should further recognize that Law and Equity grow outside the courts, too: Equity abroad, judge-made or statutory, may be as sound and "equitable" as the Equity invoked in the home forum—or more so. That, too, is *Erie*—and appropriate to *Nazareth*.

No. 26362

Denial of all compensation, future and past, to Weinstein and Fried, and their removal from office as president and director and as general manager (respectively) of the Debtor in possession, are mandatory under Chapter X, in consequence of their trading in the Debtor's stock and their self-dealing in the Debtor's rents during the Chapter X proceedings.

The principal questions before the Court in No. 26362 are the proper choice of law as to Chapter X fiduciary compensation, and the interpretation of § 249[166] and § 221(4).[167]

> "§ 249. * * * No compensation * * * shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, * * *."

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[163] *See* Gilmore, Commercial Doctrine of Good Faith Purchase, 63 Yale L. J. 1057 (1954).

[166] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).

[167] Bankruptcy Act, § 221(4); 11 U. S. C. § 621(4); 52 Stat. 897 (1938).

"§ 221. The judge shall confirm a plan if satisfied that— * * *

"(4) all payments made or promised by the debtor * * *, for service * * * in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable * * *; * * *."

The relief sought here by Wolf against Weinstein and Fried, is (1) denial of *compensation* to them out of the estate, and (2) their *removal* from office as the Debtor's president and director and as the Debtor's general manager (respectively). The misconduct constituting the grounds for that relief, is (1) their trading in the Debtor's stock, and (2) their self-dealing in the Debtor's rents, *during* the proceedings.

The law relating to fiduciary diversion and *restitution* of estate property (or indemnity for loss) is *not* necessarily the same as the law relating to compensation and removal from office; the differences in principles and results may appear in the same case.[168] Wolf's petition addressed to restitution of the rents diverted from the Debtor to Fried, was severed from the petitions at bar, and remains pending below. (*See* No. 27284, 303 F. 2d 152.) No petition is pending in any court addressed to restitution of Weinstein's and Fried's profits on their trading in the Debtor's stock. Both the Court of Appeals and the District Court confined their respective rulings to the stock trading, without ruling on the rent diversions.

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[168] *E.g., Crites, Inc.* v. *Prudential Ins. Co.*, 322 U. S. 408 (1944, *per* MURPHY, *J.*); *Beatty* v. *Guggenheim Exploration Co.*, 223 N. Y. 294, 119 N. E. 575 (1918, *per* CUDDEBACK, *J.*), *rearg.* 225 N. Y. 380, *at* 383, 122 N. E. 378 (1919, *per* CARDOZO, *J.*).

A. Both § 249 and § 221(4) mandate denial of all compensation out of the estate to Weinstein and Fried, as Chapter X fiduciaries, in consequence of their trading in the Debtor's stock during the proceedings.

In 1938, Congress enacted § 249 and § 221(4), the crucial statutes involved in No. 26362. Those provisions were part of the Chandler Act which created Chapter X and otherwise broadly amended the Bankruptcy Act.[169] The paramount aims and principles of § 249, and within the more comprehensive § 221(4), are twofold: (a) the prohibition of insider trading in the debtor's securities during the proceedings, as a Congressional and judicial *end* and policy, *per se*; and (b) the denial of compensation from the estate to insiders who trade despite the prohibition, as the *means* of effectuating that policy and attaining that end.

Before 1934, corporate reorganizations had generally been effected in federal equity receiverships. Unlike "straight" bankruptcies, where creditors and stockholders received cash liquidating dividends out of the proceeds of sale of the bankrupt's assets, reorganizations provided an *exchange* of new *securities* for old; the sale of assets to a new corporation was a fiction. By contract and under state and federal law, the rights and priorities of creditors and stockholders were defined in terms of liquidation. Absent liquidation, the priorities were theoretically respected; but, in practice, they depended upon a "plan of reorganization" which was formulated by a process of opinion evidence, argument, and bargaining as to the value of the estate as a going-concern and the participation of the different classes of securities. There was little judicial scrutiny or control. The different classes were "represented" by "protective committees"; the debtor's management, elected by the common stockholders, usually

[169] Chandler Act of June 22, 1938, ch. 575, §§ 1 *et seq.*; 52 Stat. 883 *et seq.*; 11 U. S. C. §§ 501 *et seq.*; *amending* Nelson Act of July 1, 1898, ch. 541, §§ 101 *et seq.*; 30 Stat. 544 *et seq.*

undertook to act for those stockholders, while often remaining in control of the business. By 1934, amid the great depression, equity receiverships had become infamous for insiders' abuse of the judicial process to reap windfalls for themselves by using their control and confidential information in buying and selling the debtor's securities for their own accounts during the proceedings. Moreover, virtually all control over compensation and expenses had been left by the courts in the hands of private parties, especially old management and the "protective committees", who thereby mulcted the estate directly.[170]

In 1934, exercising its powers under the Constitutional bankruptcy clause and judiciary article, Congress improved upon the equity receivership by adding § 77B to the Bankruptcy Act, so establishing a statutory form of corporate reorganization. Among the innovations were the debtor in possession ("a receivership without a receiver"), provision for recouping insider profits on purchases of the debtor's securities during the proceedings, and some degree of judicial control over compensation and expenses, provided for in § 77B(b),[171] § 77B(c),[172] and § 77B(f)(5):[173]

> "[§ 77B](b) A plan of reorganization within the meaning of this section * * *: *Provided*, That the judge shall scrutinize * * * and may limit any claims filed by such committee member or agent, to the actual consideration paid therefore. * * *"
>
> "[§ 77B](c) * * * the judge, * * * (9) may allow a *reasonable compensation* for the services rendered

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[170] *See Leiman* v. *Guttman*, 336 U. S. 1 (1949, *per* DOUGLAS, *J.*); *Northern Pac. Ry. Co.* v. *Boyd*, 228 U. S. 482 (1913, *per* LAMAR, *J.*); 6 *Collier on Bankruptcy* ¶¶ 0.04, 0.05, 7.05.

[171] Bankruptcy Act, § 77B(b) [*second proviso*]; 11 U. S. C. § 207(b); 48 Stat. 915 (1934) [*Repealed*].

[172] Bankruptcy Act, § 77B(c); 11 U. S. C. § 207(c); 48 Stat. 915 (1934) [*Repealed*].

[173] Bankruptcy Act, § 77B(f)(5); 11 U. S. C. § 207(f)(5); 48 Stat. 919 (1934) [*Repealed*].

* * * in connection with the proceeding and the plan by *officers*, * * * or other representatives of creditors or stockholders, and the attorneys and *agents* of any of the foregoing, and *of the debtor*, * * *. * * * *While the debtor is in possession* (a) its *officers* shall be entitled to receive only such *reasonable compensation* as the judge shall from time to time approve, and (b) no person shall be elected or appointed to any office, to fill a vacancy or otherwise, without the prior approval of the judge." (*Emphasis supplied.*)

"[§ 77B(f) * * * the judge shall confirm the plan if satisfied that * * * (5) all amounts *to be paid* by the debtor * * * for services or expenses incident to the reorganization have been fully disclosed and are *reasonable*, * * *." (*Emphasis supplied.*)

Under § 77B, two reorganizations in the Southern District of New York presented situations where committee members, applying to the reorganization courts for allowances of compensation, were found to have traded in securities of the debtor during the proceedings—and therefore were denied all compensation: *Paramount-Publix*[174] and *Republic Gas*.[175] In *Paramount-Publix*, in 1935, Judge Coxe invoked the phrase "reasonable compensation" in § 77B(c) and § 77B(f)(5) as statutory authority for applying principles of equity:

"All reorganization expenses are now expressly declared to be proper subjects of judicial scrutiny and determination. Indeed, there can now be no judicial confirmation of a corporate reorganization plan unless the reorganization expenses have been fully disclosed

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[174] *In re Paramount-Publix Corp.*, 12 F. S. 823 (S. D. N. Y., 1935, *per* COXE, J.).

[175] *In re Republic Gas Corp.*, 35 F. S. 300 (S. D. N. Y., 1936, *per* CAFFEY, J.).

and are reasonable, or are to be subject to the approval of the judge.' Section 77B(f)(5), * * *." [176]

> "The statute [§ 77B(c)(9)] permits the payment of *reasonable compensation* to committee members 'for services rendered.' *This necessarily implies loyal and disinterested service* in the interest of the persons for whom the committee assumes to act, and a committee member who, during his period of services, purchases and sells, or purchases, for personal gain, securities of the company which he is engaged in trying to reorganize, is not entitled to an allowance for his services as a committee member." [177]

A year later, in *Republic Gas*, Judge Caffey quoted Judge Coxe's opinion in *Paramount-Publix*, and followed Judge Coxe's reasoning and decision.

Section 77B was an emergency stop-gap measure.[178] In 1938, after much study, Congress replaced § 77B with Chapter X. Many provisions of § 77B were carried over, in modified form, into Chapter X. *E.g.:* § 77B(c)(9) [179] became § 241 [180] (*inter alia*):

> "§ 241. The judge may allow * * * reasonable compensation for services rendered * * * in a proceeding under this chapter [X]—* * * (3) by the trustee and other officers, * * *."

The last unnumbered sentence of § 77B(c) [181] became § 191: [182]

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[176] *In re Paramount-Publix Corp.*, *supra*, n. 174, 12 F. S. *at* 827.
[177] *Id.*, 12 F. S. *at* 828 (*emphasis supplied*).
[178] *See* 6 *Collier on Bankruptcy* (14th ed.) ¶ 0.05; *Report* No. 1409 *of* House Judiciary Committee *on* H. R. 8046, 75th Cong., 1st Sess. (1937), *at* 38-40.
[179] Bankruptcy Act, § 77B(c)(9), *supra*, n. 172 (*quoted in text*).
[180] Bankruptcy Act, § 241; 11 U. S. C. § 641; 52 Stat. 900 (1938).
[181] Bankruptcy Act, § 77B(c), *supra*, n. 172 (*quoted in text*).
[182] Bankruptcy Act, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938).

"§ 191. A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court."

The second proviso of § 77B(b) [183] became § 212:[184]

"§ 212. The judge * * * may limit any claim or stock acquired by such person or committee * * * in the course of the proceeding under this chapter [X] to the actual consideration paid therefor."

Section 77B(f)(5) [185] became § 221(4):[186]

"§ 221. The judge shall confirm a plan if satisfied that— * * *

"(4) all payments made or promised by the debtor * * *, for services * * *-in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable * * *; * * *."

Section 249 [187] was new; it had no explicit predecessor in § 77B.

"§ 249. * * * No compensation * * * shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, * * *."

Through a late legislative compromise, the "debtor in possession" was retained, but only in marginal cases, *i.e.*, where

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[183] Bankruptcy Act, § 77B(b) *supra*, n. 171 (*quoted in text*).
[184] Bankruptcy Act, § 212; 11 U. S. C. § 612; 52 Stat. 895 (1938).
[185] Bankruptcy Act, § 77B(f)(5), *supra*, n. 173 (*quoted in text*).
[186] Bankruptcy Act, § 221(4); 11 U. S. C. § 621(4); 52 Stat. 897 (1938).
[187] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).

indebtedness did not exceed $250,000, and where the judge so elected.[188]

Thus, much of the sweeping reform in 1938 of the 1898 Bankruptcy Act was addressed to "fiduciaries" acting in the proceedings, to assure salvage of investment, and to prevent insider plunder. "The statute [Chapter X] was designed to police the return which all security holders obtain from reorganization plans." [189] "The indicated purpose [of Chapter X] was to strengthen not to impair the existing controls which § 77B established in regard to allowances." [190] "'Reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act." [191]

Trustees and "other officers" of any estate being administered under the Bankruptcy Act, were absolutely forbidden to purchase any *assets* of the debtor during the proceedings, irrespective of the fairness of the transaction: [192]

> "§ 154. * * * Whoever, being a * * * trustee, * * *, or other officer of the court, knowingly purchases, directly or indirectly, any property of the estate of which he is such officer in a bankruptcy proceeding: * * *

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[188] Bankruptcy Act, § 156, 11 U. S. C. § 556, 52 Stat. 888 (1938); *see* 6 *Collier on Bankruptcy* ¶ 7.01[2], 7.05; *Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38) *at* 50.

[189] *Leiman* v. *Guttman*, 336 U. S. 1, *at* 8 (1949, *per* DOUGLAS, *J.*).

[190] *Leiman* v. *Guttman*, *supra*, n. 189, 336 U. S. at 5, n. 2. *See* 6 *Collier on Bankruptcy* ¶ 13.01, 1318.

[191] *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262, *at* 268 (1941, *per* DOUGLAS, *J.*); *American Mut. L. Ins. Co.* v. *City of Avon Park*, 311 U. S. 138 (1940, *per* DOUGLAS, *J.*). *See* Statement *by* William O. Douglas (then S. E. C. Commissioner) *at Hearings before* House Judiciary Committee *on* H. R. 6439, 75th Cong., 1st Sess. (1937), *at* 126.

[192] 18 U. S. C. (Criminal Code) § 154; 62 Stat. 690 (1948), *based on* Bankruptcy Act, § 29c, 11 U. S. C. § 52(c), 30 Stat. 554 (1898), 52 Stat. 856 (1938) [§ 29c *repealed*]. *See* 2 *Collier on Bankruptcy* ¶ 29.13.

"Shall be fined not more than $500, and shall forfeit his office, * * *."

In view of the nature of corporate reorganizations, the Chandler Act also undertook to prevent *all* fiduciaries from *any* purchase *or* sale of the debtor's *securities* during the proceedings. Both the reorganization legislation and the securities regulation enacted by Congress in the 1930s were in the same context, subject to the same influences, and largely directed to the same objectives.[193] However, the legal methods differed. The Securities Exchange Act of 1934, in § 16(b), provided for an absolute "constructive trust" of all insider "short-swing" profits on listed stocks "traded" (*i.e.*, bought *and* sold) within a six-month period, "For the purpose of preventing the unfair use of information which *may* have been obtained by such beneficial owner [in "control"], director, or officer by reason of his *relationship to the issuer*, * * *." [194] Congress—with much the same purpose—directed the cognate regulation of insider trading in Chapter X proceedings to compensation as well as profits. Provision for recouping insider profits on purchases of the debtor's securities, was carried over from § 77B(b) to § 212; but, unlike the § 16(b) mandate, § 212 left the Chapter X judge with discretion as to relief. *In addition* to *restitution* of insider profits, Congress prohibited *compensation* to insiders who bought *or* sold *at any time* during the proceedings—irrespective of profits; and, like § 16(b), the § 249 relief is manda-

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[193] *See, e.g., Report of* Percival E. Jackson, Counsel to Special Committee of U. S. Senate to Investigate Bankruptcy and Receivership Proceedings *etc.*, Sen. Doc. No. 268, 74th Cong., 2d Sess. (1936), *at* 51-3, 87; 2 Loss, *Securities Regulation* (2d ed., 1961), *at* 719-720, 1124-6.

[194] Securities Exchange Act of 1934, § 16(b); 15 U. S. C. § 78p (b); 48 Stat. 896 (1934) (emphasis supplied). *See Adler v. Klawans*, 267 F. 2d 840 (2d Cir., 1959), *per* BUSSEY, J.

tory. Those two sections of Chapter X—§ 212 and § 249—are cumulative, not exclusive.[195]

§ 249

The legislative history and purpose of § 249 may be seen, for example, in a statement to the House Judiciary Committee in 1937, made by William O. Douglas, a principal draftsman of Chapter X, and then a commissioner of the S. E. C., in explanation and support of § 249:

> "The Chandler bill makes further significant changes in that respect. On page 65 there is a very important provision, that those who have purchased or sold securities in contemplation of or after commencement of the proceedings should not be allowed compensation or reimbursement from the estate. Now, this is a development of the idea that fiduciaries who trade in the securities should be penalized; that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law. * * *
>
> "Now, Judge Coxe up in New York in the *Paramount* case, and Judge Caffey in the *Republic Gas* case, the opinions which were handed down in 1935 and 1936, respectively, disallowed compensation to committee members who purchased or sold securities. Now, this provision on page 65, is a step toward the codification of that rule, an attempt to make it more uniform.

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[195] *See* 6 *Collier on Bankruptcy* (14th ed.) ¶ 9.31. In the following Chapter X cases, *both* § 212 and § 249 were applied as remedies for insider trading: *Young* v. *Potts*, 161 F. 2d 597 (6th Cir., 1947, *per* SIMONS, *J.*), *on remand from Young* v. *Higbee Co.*, 324 U. S. 204 (1945, *per* BLACK, *J.*); *In re Philadelphia & Western Ry. Co.*, 64 F. S. 738 (E. D. Pa., 1946, *per* KIRKPATRICK, *J.*); *In re Los Angeles Lumber Products Co., Ltd.*, 37 F. S. 708, 46 F. S. 77 (S. D. Cal., 1941, *per* JENNEY, *J.*).

"Mr. Celler: Due to their position they trade in the securities and gain a tremendous advantage?

"Mr. Douglas: Yes; by using inside information. We started to set this up another way, to say that if a person in a fiduciary capacity uses inside information to purchase or sell securities, then he shall be penalized, but we got into a lot of difficulties. We visualized a lot of administrative difficulties in determining in a particular case whether or not actual inside information was used, and so we decided that the best practical way of doing it was to broaden the base a little bit and establish a rule of thumb and follow the pattern of the *Paramount* case and the *Republic Gas* case." [196]

Since § 249 became law in 1938, this Court has never reviewed a § 249 case. However, this Court has stated:

"* * * In all cases persons who seek compensation for services or reimbursement for expenses are held to fiduciary standards. § 249, * * *; Woods v. City Nat. Bank & T. Co. [citation].* * * *" [197]

In any event, no need for this Court to review a § 249 case had arisen—until now. For invariably, *all* fiduciaries who traded for their own accounts during Chapter X proceedings, were held subject to § 249. Motivation, ignorance, inadvertence, gain or loss: invariably, all were held irrelevant. The Courts of Appeals rigorously applied § 249 in accordance with its legislative history and purpose, from the first appellate decision in 1940—

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[196] *Hearings before* House Judiciary Committee *on* H. R. 6439, 75th Cong., 1st Sess. (1937), *at* 183-4. *See ibid.*, *at* 312-3; *Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38), *at* 127-8; *Report* No. 1916 of Senate Judiciary Committee *on* H. R. 8046 (1938), *at* 7, 38.

[197] *Brozen* v. *Gerdes*, 321 U. S. 178, *at* 182 (1944, *per* DOUGLAS, J.).

"* * * It is doubtless true that the statute, thus construed, may work a hardship in some cases—as in this; but such sporadic cases are inconsiderable compared to the large object sought to be achieved by the law, which is to fix a standard of conduct by persons acting in fiduciary capacities, in these cases, so high as to prevent any possible clash between selfish interest and faithful performance of duty." [198]

—to the last, in 1959—

"* * * But in § 249 of the Bankruptcy Act Congress clearly intended drastic results and thought them necessary to eliminate the serious abuses of insider information which had long been existent in equity reorganizations. [Citation.] In the past excuses of inadvertence or *de minimis* have not been permitted to undermine the section, and we do not feel we can narrowly constrict it here. [Cases cited.]" [199, 200]

§ 221(4)

While this Court has not ruled on § 249, this Court has, since 1938, ruled on numerous reorganization cases involving compensation to fiduciaries. Repeatedly, this Court has held that the Chapter X courts must control the acquisition and distribution of *all* assets of the estate,[201] and that the Chapter X courts have and must exercise *exclusive* jurisdiction and

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[198] *Otis & Co.* v. *Insurance Bldg. Corp.*, 110 F. 2d 333, *at* 335 (1st Cir., 1940, *per* PETERS, *J.*).

[199] *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F. 2d 862, *at* 868 (2d Cir., 1959, *per* CLARK, *C. J.*), *cert. den.* 361 U. S. 862 (1959).

[200] *Accord: In re Midland United Co.*, 64 F. S. 399, *at* 412-8 (D. Del., 1946, *per* BIGGS, *Cir. J.*), *aff'd* 159 F. 2d 340 (3d Cir., 1947, *per* KALODNER, *J.*); *In re Central States Electric Corp.* [*Henis* v. *Egan*, 112 F. S. 281 (E. D. Va., 1953, *per* HUTCHESON, *C. J.*), *lv. to app. den.* 206 F. 2d 70 (4th Cir., 1953, *p.c.*), *cert. den.* 346 U. S. 899 (1953); *In re 188 Randolph Bldg. Corp.*, 151 F. 2d 357 (7th Cir., 1945, *per* SPARKS, *J.*).

[201] *U. S.* v. *Knight*, 336 U. S. 505 (1949, *per* DOUGLAS, *J.*).

control over *all* compensation which, directly or indirectly, is paid out of the estate and which thus affects the ultimate distribution of assets in judicial custody.[202]

> "Hence Congress instituted controls, controls which became more pervasive as § 77B was evolved into Chapter X. * * * And § 221(4) is written in pervasive terms—it applies to 'all payments' for services 'in connection with' the proceeding or 'in connection with' the plan and 'incident to' the reorganization, whoever pays them. * * * "[203]

> "These practical considerations support the literal reading of § 221(4) that it is the bankruptcy court that has jurisdiction to pass on these fees. Its jurisdiction is therefore exclusive. * * * "[204]

By statute, the Chapter X courts have retained all the powers of an equity receivership court.[205] Moreover, even where § 249 does not apply—that is, in Chapter X proceedings, where conflicts of interest exist other than trading in the debtor's securities—this Court has likewise denied compensation to the faithless fiduciaries. Statutory authority is given by § 221(4), a "scrutiny clause" which was carried over into Chapter X from § 77B(f)(5). The same statutory language—"reasonable compensation"—is used in § 221(4) as was used in § 77B(c) and § 77B(f)(5), the sections which were the statutory authority for *Paramount-Publix* and *Republic Gas*; and *Paramount-Publix* has been quoted and followed by this Court in applying the "scrutiny clause" of § 221(4) to deny compensation to Chapter X fidu-

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[202] *Brozen* v. *Gerdes*, *supra*, n. 197; *Leiman* v. *Guttman*, 336 U. S. 1 (1949, *per* DOUGLAS, *J.*); *See Austrian* v. *Williams*, 216 F. 2d 278 (2d Cir., 1954, *per* HARLAN, *J.*), *cert. den.* [*sub nom. Fogarty* v. *Austrian*] 348 U. S. 953 (1955).

[203] *Leiman* v. *Guttman*, *supra*, n. 202, 336 U. S. *at* 7-8.

[204] *Id.*, 336 U. S. *at* 9.

[205] Bankruptcy Act, § 115; 11 U. S. C. § 515; 52 Stat. 884 (1938).

ciaries who had conflicts of interest during the proceedings. The landmark is the *Woods* case:

> "Under chap. X of the Chandler Act the bankruptcy court has plenary power to review all fees and expenses in connection with the reorganization from whatever source they may be payable. [Footnote, quoting § 221(4).] Reasonable compensation may be allowed. * * * Furthermore, 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act. * * * It is no answer to say that fraud or unfairness were not shown to have resulted. * * * Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation." [206]

The same strict rule stated in *Woods*—actual conflict of interest, without more, forfeits all compensation—has been applied by this Court in non-Chapter X bankruptcy reorganizations (*e.g.*, *Avon Park* [207]) and in federal receiverships outside bankruptcy (*e.g.*, *Crites* [208]). In *Avon Park*, the disqualifying conduct was insider trading in a proceeding under Chapter IX, which contains no such explicit provision as § 249, but which does contain a "scrutiny clause" similar to § 221(4). Enough that the trustee has concealed or diverted from his *cestuis* an *opportunity* for profit: the value of the opportunity, and the likelihood of its realization in quick assets, are irrelevant. Indeed, in *Crites*, this Court refused to surcharge the faithless trustee for the diverted profits—but this Court did deny him *all* compensation. "Normally" fee allowances are within the District Court's discretion, and

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[206] *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262, *at* 267-8 (1941, *per* DOUGLAS, *J.*).

[207] *American Mut. L. Ins. Co.* v. *City of Avon Park*, 311 U. S. 138 *at* 147 (1940, *per* DOUGLAS, *J.*).

[208] *Crites, Inc.* v. *Prudential Ins. Co.*, 322 U. S. 408 (1944, *per* MURPHY, *J.*).

reviewable only for "clear abuse"; but fiduciary conflict of interest "compels" complete denial of compensation.[209] The standard for fiduciary *compensation* in all *federal* receiverships, and particularly in Chapter X reorganizations, is absolute, and is different even from the federal standard for surcharge for loss or diversion of assets.

The Second Circuit soon confronted the *Woods* doctrine in Chapter X proceedings. In 1949, in the *Berner* case,[210] the Court of Appeals recognized that a fiduciary with a duty to an entire class of stockholders had no right to favor part of that class with an "opportunity" at the expense of another part of the class.[211] The applicant for compensation was not affected by § 249 because he had traded for the accounts of others, not for himself; however, the Court did find an actual misuse of confidential information, which the Court ruled a breach of trust to the sellers (though not the buyers). That was the *Avon Park* situation, and worse. Similarly, in the *Silbiger* case[212] in 1950, the Court found a conflict of interest by an attorney who had undertaken to represent two opposing classes of bondholders in the Chapter X proceedings, which the Court ruled a breach of trust; § 249 was inapplicable, since no trading was involved. That was the *Woods* situation. But in both *Berner* and *Silbiger*, the Court of Appeals ordered reduction—not complete denial—of compensation. The determination of fees was left to the district court and the parties on remand, subject to appellate review only for abuse of discretion. The amount of the reduction was to be measured largely by the amount of the insider profits.

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[209] *Id.*, 322 U. S. *at* 418.

[210] *Berner* v. *Equitable Office Bldg. Corp.*, 175 F. 2d 218 (2d Cir., 1949, *per* L. HAND, *J.*).

[211] *Id.*, *citing* (175 F. 2d *at* 220, n. 1) *Young* v. *Higbee Co.*, 324 U. S. 204 (1945, *per* BLACK, *J.*).

[212] *Silbiger* v. *Prudence Bonds Corp.*, 180 F. 2d 917 (2d Cir., 1950, *per* L. HAND, *J.*), *cert. den.* 340 U. S. 813 (1950).

> "* * * Nevertheless, since Congress limited the penalty of entire forfeiture to purchases by a fiduciary [under § 249], we should not be warranted in extending that penalty to the situation at bar; and we think that *the consequences should be only those which attend any breach of trust in equity*; i.e., that in determining what the trustee's compensation shall be, the court will, as a matter of *discretion diminish* the allowance which it would otherwise make, *in proportion to the gravity of the breach.* * * *" [213]

Thus came the enfeebling of § 221(4), *Woods*, and *Aron Park* in the Second Circuit, and the blurring of the distinction between denial of fiduciary compensation and restitution of insider profits. Cited were *Woods* and *Crites*, but not § 221(4). Where § 249, narrowly construed, was inapplicable, the Court looked to *general* equitable standards in all jurisdictions, not specifically to federal standards. The remedy was not absolute forfeiture of compensation; rather, it was reduction of compensation, gauged by the amount of the diverted assets—an alternative (as it were) to surcharge, which required proof of actual loss to the *cestuis* and a finding of good faith or bad faith.[214]

The inevitable has come in this case. Section 249 is construed to near-death. Section 221(4) is not cited. Now the remedy for insider trading is completely "equitable" and discretionary. Neither the Court of Appeals nor the District Court (on remittitur) has opted to impose the remedy at all. The rationale is recourse to state law, and the utter exclusion of federal law. The finale is disclaimer of breach of trust by a Chapter X fiduciary who buys or sells the

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[213] *Berner* v. *Equitable Office Bldg. Corp.*, *supra*, n. 210, 175 F. 2d *at* 222 (*emphasis supplied*).

[214] *See also Nichols* v. *S. E. C.*, 211 F. 2d 412, *at* 416-8 (2d Cir., 1954, *per* L. HAND, *J.*), *cert. den.* 348 U. S. 828 (1954); *In re Chicago & West Towns Rys., Inc.*, 230 F. 2d 364 (7th Cir., 1956, *per* DUFFY, *C. J.*), *cert. den.* 351 U. S. 943 (1956).

debtor's securities for his own account during the proceedings. The decision below confounds the language and policy of both § 249 and § 221(4), and clouds a hitherto clear *caveat* to all Chapter X insiders.

The Court of Appeals rested its decision on a strict construction of § 249. Purely as statutory construction, it is erroneous. More important, however, was the judicial *election* to construe § 249 strictly, not liberally, and the judicial inference of legislative intent. Without question, Congress may regulate Chapter X compensation, and may disqualify an applicant if he trades in the debtor's stock during the proceedings. Administration of bankruptcy estates is peculiarly within federal jurisdiction. The Court of Appeals has viewed such disqualification as "penal" (R. 580), not as "remedial."[215] Hence, its strict construction: Unless Congress has spoken unequivocally, § 249 does not apply; absent applicability of § 249, state law or "general" equity applies instead—which does not disqualify corporate managers from compensation in consequence of insider trading *per se*. The following words are the crux of Judge Friendly's opinion:

> "* * * Not being required to seek compensation under § 247, they have not been subjected to § 249, and the order of removal cannot survive the fall of its underpinning. [Footnote 5]" (R. 579)
>
> "* * * For these strangers [judge's appointees] the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from *consensual arrangements*, subject only, in the case of officers, to judicial approval under § 191. * * * At the very least, courts are justified in demanding a clear indication of Congressional purpose before inflicting what we have recognized as so harsh a forfeiture, [case cited], upon persons who,

[215] *Cf. Adler* v. *Klawans*, 267 F. 2d 840, *at* 844 (2d Cir., 1959, *per* BURGER, J.).

despite their fiduciary obligations, had been free to buy or sell stock of the corporation before the Chapter X proceeding was contemplated [cases cited]. * * *." (R. 580; *emphasis supplied.*)

"* * * Chapter X clearly distinguishes between *what is demanded* of a trustee and *what is expected* of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional trustee * * *) must be 'disinterested.' * * *. No such requirement was or practically could be imposed on officers of the debtor; * * *." (R. 580-1; *emphasis supplied.*)

"* * * Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees [Wolf] complain; * * *." (R. 582)

1. At once, there is a new order when a Chapter X petition is filed: federal law supervenes; the federal judge, above the stockholders, above the state legislature, is master; the debtor's officers are his servants. Some officers the judge newly appoints; some continue in service at executive level with his approval. The latter are compensated by regular salaries, instead of in gross at the winding-up.[216] Now says the Court of Appeals, the correlate of that *privilege* of continued service and regular salary (without "disinterestedness") would be, not a responsibility, but a license to trade in the debtor's securities during the proceedings, as before. Their trading would still be no breach of trust, absent proof of actual over-reaching and actual profit; even then, the remedy would be limited to restitution of their profits. In short, fiduciaries not required to *be* "disinterested" at the *commencement* of the Chapter X proceedings, would *also not* be required to *act* in a disinterested manner *during* the Chapter X proceedings. For them, Chapter X would bring no

[216] Bankruptcy Act, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938).

change. The strict federal standard would apply only to the few "disinterested" at commencement, while the loose non-federal standard would apply to the many not "disinterested"—though *all* had "assumed to *act in the proceedings* in a fiduciary capacity" (§ 249).

2. The Court of Appeals would disregard the *functions* of key operating personnel, their access to confidential information, and their actual control of the debtor being reorganized. Not their powers and acts, but their titles, would define their responsibilities—despite the lucid functional definitions of the Bankruptcy Act and the equity courts. Form, not substance, would govern.[217]

3. The decision below does not merely chip at § 249. It cleaves the statute and emasculates judicial control of compensation in Chapter X proceedings, thereby thwarting the Congressional and judicial purpose of preventing and penalizing insider trading. For the license to trade given by that decision would extend, not only to officers of a debtor in possession in a small case, but to all key operating personnel employed by a trustee or a debtor, in any case, big or small.

Moreover, the refusal to apply § 249 or § 221(4) or non-statutory principles of equity in Chapter X proceedings, would be precedent for like refusal in railroad reorganizations under § 77,[218] in S.E.C. public utility reorganizations,[219] and in other reorganization proceedings under the

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[217] Bankruptcy Act, §§ 1(22), (23), 188; 11 U. S. C. §§ 1(22), 1(23), 588; 52 Stat. 840, 892 (1938); *see* Point C, *infra*

[218] *See R. F. C. v. Bankers Trust Co.*, 318 U. S. 163 (1943, *per* ROBERTS, J.); DOUGLAS, J., *concurring*); 5 *Collier on Bankruptcy* ¶ 77.28.

[219] *See S. E. C. v. Dumaine*, 218 F. 2d 308 (1st Cir., 1954, *per* WOODBURY, J.), *cert. den.* 349 U. S. 929 (1955); *cf. Nichols v. S. E. C.*, 211 F. 2d 412 (2d Cir., 1954, *per* L. HAND, J.); *see also* 2 Loss, *Securities Regulation* (2d ed., 1961), *at* 1127-9.

Bankruptcy Act,[220] where the applicable statutes all contain language similar to the language of § 249 or § 221 (4).

4. As to the format and definitions of Chapter X:

(a) Judge Friendly has written that the "context" of § 249 is confined to Article XIII (§§ 241-250); *therefore*, § 191, in Article VIII, is not governed by § 249 (R. 579). The reason stated is *ipse dixit:* "it becomes fairly plain" (*Id.*). Yet, the legislative history shows an intention that the format was *not* to restrict the substantive application of any sections of Chapter X; *e.g.:*

> "* * * Thus it is that the largest part of the changes in the language of section 77B to be found in chapter X of this bill, are solely in the interests of clarification. For the most part, also, the rearrangement in this chapter of the provisions of section 77B has as its purpose a more logical order and grouping of related provisions which are presently to be found scattered throughout section 77B in much confusion. * * *" [221]

The point was made not only at hearings and in committee reports, but explicitly by statute:

> "b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate." [222]

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[220] *E.g.*, Ch. IX; *see American Mut. L. Ins. Co.* v. *City of Avon Park*, 311 U. S. 138 (1940, *per* DOUGLAS, J.); *see also* 5 *Collier on Bankruptcy* ¶ 81.23.

[221] *Report* No. 1916 *of* Senate Judiciary Committee *on* H. R. 8046 (1938), *at* 19. *See also Hearings before* House Judiciary Committee *on* H. R. 6439, 75th Cong., 1st Sess. (1937), *at* 313-8; *Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38), *at* 117-9; 6 *Collier on Bankruptcy* ¶¶ 13.02, 13.16.

[222] Amendatory Act, § 5b; Additional Provisions of Act of June 22, 1938 (The Chandler Act, ch. 575, 52 Stat. 840 *et seq.*), § 5b; 11 U. S. C. § 1, notes, § 5b.

(b) Article XIII on "Compensation and Allowances" (§§ 241-250) is *not* self-contained. Article XI, on "Confirmation and Consummation of Plan" (§§ 221-229) also governs compensation; indeed, it contains the "scrutiny clause," § 221(4), which this Court has said to be "pervasive" of Chapter X,[223] and to govern Article XIII applications for allowances.[224] No reason appears to make § 249 any less "pervasive."

(c) Both § 241 and § 191 were derived from § 77B(c). The requirement that compensation be "reasonable" had been repeated in § 77B(c)(9) and in the last unnumbered sentence of § 77B(c), and again in § 77B(f)(5). That critical word "reasonable" was carried from § 77B(f)(5) into § 221(4), and from § 77B(c)(9) into § 241; but the word was omitted when the last unnumbered sentence of § 77B(c) was carried into § 191. The judge must still "approve" all compensation under § 191, as under its § 77B(c) predecessor. Unless the judge is now free to approve "*un*reasonable" compensation to officers of a debtor in possession, the standards governing such compensation must be found *outside* § 191 (Article VIII). There is no less reason to import § 249 from Article XIII into § 191, than to import the "pervasive" § 221(4) from Article XI.

(d) Referee Joyce (R. 41-2) and the respondents contend, and Judge Friendly suggests (R. 579), that the second sentence of § 249 (the denial of compensation) cannot apply unless the first sentence (the requirement of disclosing trading transactions) applies. Neither reason nor authority is given. *Assuming* the two sentences of § 249 must both apply, then the substantive policy of the second sentence should determine the disclosure procedure, *et vice versa*. Nor would weekly statements be required for weekly paychecks.

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[223] *Leiman* v. *Guttman*, *supra*, nn. 202-4 (*quoted in text*).

[224] *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262 (1941, *per* DOUGLAS, *J.*).

any more than statements under (say) § 210[225] need be filed prerequisite to each separate appearance in court by an attorney. Statements filed pursuant to Chapter X requirements are continuing representations to the court; additional statements need be filed only when new circumstances require new disclosures.[226]

5. The Court of Appeals has premised two principal distinctions for its posited double standard, in order to square its statutory construction with Congressional intent:

(a) "*Disinterested*": Whether an applicant for compensation out of the estate is required to be "disinterested" under § 158,[227] is immaterial to the applicability of § 249 and § 221(4). Under Chapter X, *only* the trustee,[228] the trustee's attorney,[229] and the examiner[230] are required to be "disinterested." It is not alone the officers and employees of a debtor in possession who need not be "disinterested." Likewise, virtually every other person serving in the proceedings, and looking to the estate for compensation, need *not* be "disinterested"; *e.g.*, the "additional trustee,"[231] attorneys on special retainers[232] and others employed by the trustee,[233] indenture trustees, committee members. *All* those persons, "disinterested" or not, will either apply for allowances under Article XIII, or their out-of-court compensation agreements with their clients will *necessarily* be subject to review of "reasonableness" by the Chapter X court under § 221(4). If those persons alone were subject to § 249 who were required to be "disinterested" under § 158, then § 249 would not govern most applicants for compensation under Article XIII.

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[225] Bankruptcy Act, § 210; 11 U. S. C. § 610; 52 Stat. 895 (1938).
[226] *See* 6 *Collier on Bankruptcy* ¶¶ 9.28-9.30.
[227] Bankruptcy Act, § 158; 11 U. S. C. § 558; 52 Stat. 888 (1938).
[228] Bankruptcy Act, § 156; 11 U. S. C. § 556; 52 Stat. 888 (1938).
[229] Bankruptcy Act, § 157; 11 U. S. C. § 557; 52 Stat. 888 (1938).
[230] Bankruptcy Act, § 168; 11 U. S. C. § 568; 52 Stat. 890 (1938).
[231] Bankruptcy Act, § 156, *supra*, n. 228.
[232] Bankruptcy Act, § 157, *supra*; n. 229.
[233] Bankruptcy Act, §§ 167(4), 191; 11 U. S. C. §§ 567(4), 591; 52 Stat. 890, 893 (1938). *See* 6 *Collier on Bankruptcy* ¶¶ 7.21, 8.14.

where § 249 is situated. And if those persons alone were subject to § 221 (4) and *Woods* who were required to be "disinterested" under § 158, then, in reviewing out-of-court compensation agreements, "reasonableness" would no longer "necessarily imply loyal and disinterested service."

The error below is the misconstruction of "disinterested." The word has two meanings. As used in § 158, "disinterested" is a term of art derived from *statute* and descriptive of a person's *status* at or *prior* to his appointment and the filing of the Chapter X petition. As used in *Woods* ("loyal and disinterested service"), the word is a term of art derived from *equity* and descriptive of a person's *conduct subsequent* to his appointment and throughout the proceedings.

The persons required to *be* "disinterested" under § 158 (trustee, trustee's attorney, examiner) are obliged to investigate the debtor's pre-Chapter-X operations, to advise on action against insiders and preferred creditors, and to formulate a plan of reorganization presumptively "fair and equitable" to all classes and presumptively "feasible" in avoiding the incompetent and/or fraudulent mismanagement that may have precipitated reorganization.[234] The man who was part of pre-Chapter-X management yesterday will not investigate himself today; the man who is a creditor or stockholder will favor the class of which he himself is a member; so Congress presumed—conclusively. The obligatory *functions* of the § 158 "disinterested" affect all classes interested in the estate; the *duty* to *all* bars identification with any.

By contrast, the obligatory functions of other Chapter X "fiduciaries" do not conflict with personal identification with a class; *e.g.*, representation of a particular class by a com-

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[234] *See* Bankruptcy Act, §§ 167, 168; 11 U. S. C. §§ 567, 568; 52 Stat. 890 (1938); *see also* 6 *Collier on Bankruptcy* ¶¶ 7.17-7.24; *Hearings before* House Judiciary Committee *on* H. R. 6439, 75th Cong., 1st Sess. (1937), *at* 174-7; *Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38), *at* 125-6.

mittee member or attorney, or operation of the debtor's business by its officers to preserve and enhance the estate for all classes. The duties imposed on a debtor in possession do not include those duties imposed on a trustee which require "disinterested" status; hence, provision for an examiner. Nevertheless, undertaking any duty to one class or more, the Chapter X "fiduciary" owes "disinterested" *conduct* in performance of that duty, under *Woods*. Once "disinterested" conduct is owed, the specific bar and mandate of both § 249 and § 221(4) apply. Thereupon, the courts will not inquire into particular effects upon particular classes, *for compensation purposes*. If this is true of committee members and attorneys who owe a duty to particular classes only, it is true, *a fortiori*, of the officers of a debtor in possession who have undertaken a duty to all classes in the operation of the business.

(b) *"Consensual arrangement":* The distinction between "interposition by the court" and "consensual arrangement" as the mode of appointment and/or compensation, is immaterial to the applicability of § 249 and § 221(4). Except the trustee, the additional trustee, the trustee's attorney, and the examiner, virtually every other person serving in the proceedings, and looking to the estate for compensation, is appointed and compensated by "consensual arrangements" with his respective clients. Nevertheless, *all* appointments are subject to judicial approval.[235] Even prospective management after the winding-up, are subject to judicial approval.[236] Likewise, *all* compensation is subject to judicial approval.[237] As likely as not, the prospective recipient of

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[235] Bankruptcy Act, §§ 157, 167(4), 191, 212, *supra*, nn. 229, 233, 184. *See Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38), *at* 127-8; *Report* No. 1916 *of* Senate Judiciary Committee *on* H. R. 8046 (1938), *at* 36.

[236] Bankruptcy Act, § 221(5); 11 U. S. C. § 621(5); 52 Stat. 897 (1938).

[237] *Leiman* v. *Guttman*, 336 U. S. 1 (1949, *per* DOUGLAS, *J.*); *Brown* v. *Gerdes*, 321 U. S. 178 (1944, *per* DOUGLAS, *J.*).

compensation (*e.g.*, indenture trustee) will have served before as well as during the proceedings; and he may expect to serve afterwards, too. His compensation may have been fixed by contract with the clients or class he represents; the contract may have been executed either before or during the proceedings; and he may be paid by his clients out of court, not by the trustee's disbursement.[238] Even if he applies to the Court at the winding-up for allowance under Article XIII, he may have a "consensual arrangement" with other persons interested in the estate, to avoid their objection; *e.g.*, his own clients may have an interest in the allowance of a large fee to him from the general estate where that fee will reduce the fee payable directly by his own clients out of their distributive share of the estate.[239] The parties' acquiescence in compensation applications is only evidentiary: "Every important determination by the court in receivership proceedings calls for an informed, independent judgment."[240]

The error below is the misconception of the force of contracts during Chapter X proceedings. *Any* contract which *may* diminish the estate, directly or indirectly, compels the judge's approval. The judge is an indispensable party to all contracts involving the estate; absent his approval, all such contracts are void.[241] He may authorize an *ordinary* course of business by the trustee or debtor, and excuse prior submission of routine to him, subject to accounting at the winding-up; and this may effect an estoppel of sorts in favor of

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[238] *Leiman* v. *Guttman*, *supra*, n. 237.

[239] *See Silbiger* v. *Prudence Bonds Corp.*, 180 F. 2d 917, *at* 923 (2d Cir., 1950, *per* L. HAND, *J.*), *cert. den.* 340 U. S. 813 (1950).

[240] *National Surety Co.* v. *Coriell*, 289 U. S. 426, *at* 436 (1933, *per* BRANDEIS, *J.*); *First National Bank of Cincinnati* v. *Flershem*, 290 U. S. 504, *at* 525 (1934, *per* BRANDEIS, *J.*). *See* 6 *Collier on Bankruptcy* ¶ 13.02; 3 *Id.* ¶ 62.05[3].

[241] Bankruptcy Act, §§ 116(2), (3); 11 U. S. C. §§ 516(2), (3); 52 Stat. 885 (1938). *See* 6 *Collier on Bankruptcy* ¶¶ 3.26, 3.27; *and see* Point B(3), *infra*.

third parties dealing with the trustee or debtor in possession: *e.g.*, wages to operational employees may be fixed and paid by the debtor's officers under the order authorizing the debtor to operate its business. But compensation to "fiduciaries"—including "officers"—is *extraordinary*, and does require the judge's prior approval. In effect, all service by "fiduciaries" in Chapter X proceedings remains subject to *quantum meruit*. There can be neither service nor compensation without "interposition by the court," regardless of "consensual arrangements."

Whether the § 221(4) requirement of "reasonableness" would permit re-negotiation of § 191 employment contract earlier judicially approved, on a complaint of incompetent performance, is immaterial here. What is material, is that the requirement of "reasonableness" is a requirement of "loyal and disinterested service," irrespective of competency. When service in Chapter X proceedings is not "loyal and disinterested," the employment contract is voidable and there can be no recovery in *quantum meruit*.[242]

6. Beneath the Court of Appeals' inference of Congressional intent, and the Court's election to construe § 249 strictly, are a reliance on principles of "general" equity and state law as the norm, and a disfavor of any deviation from those principles, even by Congress, even toward stricter fiduciary standards.

(a) Judge Friendly wrote that corporate managers, "despite their fiduciary obligations, had been free to buy or sell stock of the corporation before the Chapter X proceeding was contemplated" (R. 580), *i.e.*, under state law. In support of that proposition, Judge Friendly cited two decisions of this Court addressed to corporate recoupment of trading profits (not to denial of fiduciary compensation), and based on in-

[242] *Cf. U. S. v. Miss. Valley Generating Co.* ["*Dixon-Yates*"], 364 U. S. 520, *at* 564-5 (1961, *per* WARREN, *C. J.*).

herent chancery powers (not on legislation).[243] Implicit in that proposition are several presumptions, *viz.*: Corporate stock is not property *of* the corporation, so a corporate manager does not self-deal in entrusted property when he buys or sells stock. A corporate manager has only a *derivative* or indirect duty to the stockholders, since the scope of his duties extends only to the corporate property; he has no *direct* or express fiduciary duty to the stockholders, unlike (say) a protective committee representing the stockholders themselves; he is a *quasi*-trustee. A business corporation is normally not interested in buying its own stock in the market, and is indifferent to the identity of its stockholders (or even encourages stock purchases by its managers, for "incentive"); the availability of stock is not a "corporate opportunity." *Therefore*, the managers may buy and sell stock for their own accounts.

(b) Under state law, those presumptions are rebuttable; corporate managers are not absolutely "free" to trade in their corporation's securities. True, if the securities are not the subject of their trust, their liability would arise (if at all) at law, in fraud or deceit, upon misrepresentations to persons with whom they (like anyone else) were otherwise "free" to trade and compete. The persons aggrieved would be they alone who sold for too little or bought for too much. The suit would be for indemnity for actual loss incident to a misrepresentation in fact. But the corporate managers' liability to stockholders or the corporation would arise in equity where the managers had taken for themselves an "opportunity" in which their corporation was in fact "interested," or where they did have a direct obligation to the stockholders (*e.g.*, where they had sold "control" the proceeds of which they were bound to share with other stock-

[243] *S. E. C. v. Chenery Corp.*, 318 U. S. 80, *at* 88 (1943, *per* FRANKFURTER, J.) [*but see, after remand*, 332 U. S. 194 (1947, *per* MURPHY, J.)]; *Manufacturers Trust Co. v. Becker*, 338 U. S. 304, *at* 312-4 (1949, *per* CLARK, J.).

holders).[244] If the securities (or the "opportunity" therefor) become the subject of a trust, it is not simply the loss to the *cestuis* which must be indemnified; the fiduciary's personal profit in the transaction becomes an unjust enrichment subject to restitution. With the "express trust," the self-dealing is absolutely prohibited; restitution of all fruits will be decreed (profits *and* compensation) upon proof of self-dealing, *per se*.[245] Corporate "fiduciary" relationships are a hybrid "trust": the self-dealing is not absolutely prohibited; but, if the "opportunity" is the subject of the "trust" (*i.e.*, within the managers' duties), the burden of proof (including the risk of persuasion) shifts to the defendant-fiduciary to show that the transaction between corporation and manager carried the "earmarks of an arm's length bargain" between corporation and stranger,[246] or that the transaction between manager and stranger was one which the controlled corporation fairly would have declined to engage in for itself.

(c) Even in his own terms, Judge Friendly has overstated the respondents' case. The availability of the Debtor's stock was a "corporate opportunity," as a matter of (Pennsylvania) law. For an overissue has been outstanding since early 1953, before—and since—the reorganization was contemplated. If any stock-claimant here bought stock which the courts should ultimately void by reason of overissue, then—

> "• • • (a) if an identical security which does not constitute an overissue is reasonably available for purchase, the person entitled to issue or validation may

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[244] *See Southern Pacific Co.* v. *Bogert*, 250 U. S. 483 (1919, *per* BRANDEIS, *J.*); *Young* v. *Higbee Co.*, 324 U. S. 204 (1945, *per* BLACK, *J.*).

[245] *Michoud* v. *Girod*, 4 How. (45 U. S.) 503 (1846, *per* WAYNE, *J.*); *Magruder* v. *Drury*, 235 U. S. 106 (1914, *per* DAY, *J.*).

[246] *See Pepper* v. *Litton*, 308 U. S. 295, *at* 306-7 (1939, *per* DOUGLAS, *J.*).

compel the issuer [Debtor] to *purchase* and deliver such security to him * * *."[247]

Pennsylvania even authorizes a corporation to borrow in order to acquire its own shares.[248] Absent such "reasonably available" stock—in a rising market (as here)—the stock claimant could recover only his purchase price (paid between 1951 and 1953).[249]

If the same misconduct proved here had been committed *outside* a Chapter X proceeding, a state court might award the Debtor recovery of trading profits[250] (as well as recovery of diverted rents[251]) as against Weinstein and Fried. Indeed, in these Chapter X proceedings, the same misconduct may bring such relief, and may be judged by a state-like standard of proof: *i.e.*, liability may require further proof of actual overreaching by Weinstein and Fried and actual prejudice to their *cestuis*.[252] Under those standards, the court

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[247] 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 8-104(a); P. L. 3, § 8-104(a) (1953), *as amended* P. L. 1023, § 8 (1959) (*emphasis supplied*). *See Prince* v. *Childs Co.*, 23 F. 2d 605, *at* 608 (2d Cir., 1928, *per* A. N. HAND, *J.*).

[248] Pa. Bus. Corp. L. § 302(8); 15 Purdon's Pa. Stats. Ann. § 2852-302(8); P. L. 364, Art. III, § 302(8), *amended* P. L. 711, § 1 (1957). *See Mulford*, Corporate Distributions to Shareholders and Other Amendments to Pa. Bus. Corp. Law, 106 U. Pa. L. Rev. 536, *at* 565-6 (1958).

[249] 12A Purdon's Pa. Stats. Ann. § 8-104(b), *supra*, n. 247.

[250] *See Bailey* v. *Jacobs*, 325 Pa. 187, 189 A. 320 (1937, *per* STERN, *J.*); *Lutherland, Inc.* v. *Dahlen*, 357 Pa. 143, 53 A. 2d 143 (1947, *per* STERN, *J.*); *Weissman* v. *A. Weissman, Inc.*, 374 Pa. 470, 97 A. 2d 870 (1953, *per* JONES, *J.*), 382 Pa. 189, 114 A. 2d 797 (1955, *per* CHIDSEY, *J.*); *Hozell* v. *McCloskey*, 375 Pa. 100, 99 A. 2d 610 (1953, *per* ARNOLD, *J.*).

[251] *See Rivoli Theatre Co., Inc.* v. *Allison*, 396 Pa. 343, 152 A. 2d 449 (1959, *per* BOK, *J.*); *Hempstead Theatre Corp.* v. *Metropolitan Playhouses, Inc.*, 6 N. Y. 2d 311, 189 N. Y. S. 2d 837 (1959, *per* FROESSEL, *J.*).

[252] *See* Bankruptcy Act, § 212, 11 U. S. C. § 612, 52 Stat. 895 (1938); *Mosser* v. *Darroze*, 341 U. S. 267 (1951, *per* JACKSON, *J.*); *Governor Clinton Co., Inc.* v. *Knott*, 120 F. 2d 149 (2d Cir., 1941, *per* CLARK, *J.*), *cert. dismd.* 314 U. S. 701 (1941); 6 *Collier on Bankruptcy* (14th ed.) ¶ 9.31.

might have to decide whether, years ago, the Debtor or any of its stockholders had sufficient funds and inclination to buy the stock which Weinstein and Fried bought, or would likewise have sold their stock at the same price (or whether, years ago, the Debtor might have made a better race-track lease with a stranger when Weinstein and Fried reduced Fried's rents and diverted another tenant's [LaGrotte's] rents from the Debtor to Fried). A state court might also deny compensation to Weinstein and Fried for the same misconduct, even though the evidence did not warrant restitution or indemnity.

> "* * * An agent is held to the utmost good faith in his dealings with his principal; if he acts adversely to his employer in any part of the transaction or omits to disclose any interest which would naturally influence his employer's conduct in dealing with the subject of employment, it is such a fraud upon his employer as forfeits any right to compensation for his services.* * *"[253]

And a state court might remove Weinstein and Fried from office.[254]

(d) Twentieth Century economic and social conditions require adaptation of Seventeenth Century principles of equity. The corporate "fiduciary" is a hybrid trustee. The equitable standards applicable to his relationships and conduct, have been continually adapted from the "express trust" as equity has taken cognizance of business matters; the sub-

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[253] *Beatty* v. *Guggenheim Exploration Co.*, 223 N. Y. 294, *at* 304, 119 N. E. 575 (1918, *per* CUDDEBACK, *J.*); *cf. s.c., rearg.*, 225 N. Y. 380, *at* 383, 122 N. E. 378 (1919, *per* CARDOZO, *J.*). *See Alleghany By-Products Coke Co.* v. *J. H. Hillman & Sons Co.*, 275 Pa. 191, 118 A. 906 (1922, *per* SADLER, *J.*); *Wendt* v. *Fischer*, 243 N. Y. 439, 154 N. E. 303 (1926, *per* CARDOZO, *C. J.*); *Elco Shoe Mfrs., Inc.* v. *Sisk*, 260 N. Y. 100, 183 N. E. 191 (1932, *per* POUND, *C. J.*).

[254] *See Markovitz* v. *Markovitz*, 336 Pa. 145, 8 A. 2d 46 (1939, *per* BARNES, *J.*); *People* v. *Lyon*, 119 A. D. 361, 104 N. Y. S. 319 (1st Dept., 1907, *per* SCOTT, *J.*).

jects of his "trust" have been expanded as business has grown in complexity. There is no perpetuity or sanctity in fixing corporate fiduciary standards *below* the fiduciary standards applicable to the express trustee, nor in limiting the subjects of a trust to property to which actual title or possession is delivered. The courts of equity have come to acknowledge that the hallmark of the fiduciary relationship is *power*, derived from and confided by a court and/or the beneficial owners of property.

> "* * * It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation." [253]

Advisedly, Congress used the word "fiduciary"—not "trustee"—in § 249.

Any "fiduciary" serving in a Chapter X proceeding, must be satisfied with the reward of "reasonable compensation for services rendered"; there is no room for fringe benefits or side deals. What he takes which touches the estate, he must take for the class he serves. If a member, he receives his *aliquot* share of what his class of *cestuis* receive—and nothing more. If he is faithful, he earns fair and "reasonable compensation"; if he is not faithful, he forfeits all compensation. By denying compensation for disloyalty, Congress and the courts do not indemnify the *cestuis*, nor rectify an unjust enrichment; therefore, the "wrong" to a particular *cestui* is immaterial. It is the *conduct* by any "fiduciary" in the proceedings which is regulated. The particular consequences of his self-dealing or conflict of interest are immaterial to his eligibility for compensation. There is nothing new in equity in this. In § 249 and § 221(4) (as construed by *Woods*), Congress has stated facts and consequences. Its condemnation and mandate are entitled to the same judicial respect

[253] *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, *at* 487 (1919), *per* BRANDEIS, *J.*). *See* Pa. Bus. Corp. L. § 408; 15 Purdon's Pa. Stats. Ann. § 2852-408; P. L. 364, Art. IV, § 408 (1933).

as if Congress—or a judge—had attached a label of "trustee" relationship in traditional equity terms.

7. In sum: What other jurisdictions would do, is immaterial here. Immaterial, too, is what a Chapter X court would do if Wolf were seeking relief as against Weinstein and Fried other than denial of compensation and removal from office. Congress and this Court have spoken: § 249, § 221(4), and *Woods* mean precisely what they say. No exegesis—surely not respondents'—can subtract from the clear, cogent bar and mandate. The field is federally preempted. The federal standard for fiduciary compensation is simply higher and stricter than under comparable "general" equity or state law.

By statute, the Chapter X judge must approve all appointments and must approve all compensation. The jurisdiction over compensation is exclusive. Unless that exclusive jurisdiction over compensation carries with it the substantive fiduciary standards set by § 249 and § 221(4), the jurisdiction is hollow.

The double standard posited by the Court of Appeals is utterly inconsistent with the single and absolute standard which should be exacted of all fiduciaries in Chapter X proceedings, regardless of their mode of compensation and their mode of appointment. It is the *source of compensation*—the estate in judicial custody—which gives the Chapter X court exclusive jurisdiction over compensation *and* which should impose a single standard of conduct and compensation for all Chapter X fiduciaries.

B. Section 221(4) mandates denial of all compensation out of the estate to Weinstein and Fried, as Chapter X fiduciaries, in consequence of their diversions of the Debtor's rents to Fried during the proceedings.

Any actual conflict of interest—not alone trading in the Debtor's securities by a Chapter X fiduciary during the proceedings, brings a forfeiture of all compensation to him, pursuant to § 221(4). Here, Weinstein and Fried, in addition to trading in the Debtor's stock, engaged in a lengthy deliberate course of self-dealing, to the end of diverting the Debtor's rents during the proceedings into Fried's corporate pocketbook, Nazareth Enterprises, Inc. ("Enterprises"). The record shows Fried to have been the sole beneficiary of those diversions. Weinstein participated in the misconduct, but not in the fruits. (*See* pp. 36-41, *supra*.) Though it hardly matters under *Woods*, Weinstein was not disinterested: he was entangled with Fried in their common traffic in the Debtor's stock for much of the period of the rent diversions, including at least one occasion during that period when Weinstein acted as Fried's attorney-in-fact in Fried's purchases of shares. (*See* p. 35, *supra*.)

1. [257] The race-track matter has been relied on by Wolf in No. 26362 as alternative ground for denial of compensation and removal from office. The District Court denied part of the relief sought (recoupment of past compensation), and the Court of Appeals denied all; so, neither Court below made any findings or conclusions on the race-track matter. Where alternative grounds are alleged, the denial of relief on one ground requires a ruling—including findings and conclusions—on the alternative grounds.[257a]

2. The written race-track lease—unless and until modified, cancelled, or rejected by the Chapter X court—stands as

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[257] Rules 8(a), 52, F. R. Civ. P., *f.* 28 U. S. C. § 2072; *Sims v. Capitol Refrigeration Co., Inc.*, 294 F. 2d 111, *at* 115 (2d Cir. 1961, *per* WATERMAN, J.).

the instrument determining the rents due from Enterprises (Fried) to the Debtor during these proceedings. Section 116(3) authorizes new leases by a trustee or debtor in possession *only* upon the prior approval of the court.[258] Weinstein alone, *qua* president, had no independent power to make a new lease. Absent court approval, the change was void.[259] All rents withheld or diverted by reason of that void oral change in the race-track lease, were the Debtor's.

Respondents rely on *dictum* that § 116(3) permits sales and leases in the regular course of business of a debtor in possession, without prior judicial authorization—but only where the item involved is "trifling"; and the *dictum* continues, "No doubt any *unusual* contract would require express authorization, but *normal* purchases and sales would be permissible without a special order."[260] The race-track lease is not "trifling"; the change was a vastly new lease, and was not "normal." Of the Debtor's many written leases (not at will), the race-track lease is the *only* written lease ever changed by Weinstein and Fried in the nine years of these proceedings without prior judicial authorization (R. 473-4). No lease between the Debtor and Fried—while Fried was the Debtor's general manager—could be "usual" or "normal."

3. There is not, and never has been, a written agreement with LaGrotte or J&J covering the Nazareth race-track food-concession rents, notwithstanding the three written leases or licenses between the Debtor and LaGrotte and J&J covering the food-concession inside the Market. Absent a writing, the

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[258] Bankruptcy Act, § 116(3), 11 U. S. C. § 516(3), 52 Stat. 885 (1938).

[259] *See Wolf* v. *Nazareth Fair Grounds & Farmers' Market, Inc.*, 280 F. 2d 891 (2d Cir., 1960, *p.c.*); *In re American Cooler Co., Inc.* [*Standard Capital Corp.* v. *Safer*], 115 F. 2d 383 (2d Cir., 1940, *p.c.*), 125 F. 2d 496 (1942, *per* FRANK, *J.*); *In re Avorn Dress Co., Inc.*, 78 F. 2d 681, 79 F. 2d 337 (2d Cir., 1935, *per* SWAN, *J.*); 6 *Collier on Bankruptcy* ¶¶ 3.26, 3.27.

[260] *In re Avorn Dress Co., Inc., supra*, n. 259, 78 F. 2d *at* 681; *see* 6 *Collier on Bankruptcy* ¶ 3.27[2], *at* 730-1.

best evidence of an oral contract is the *practice* of the parties at the times in issue—here, in September of 1953, when these proceedings commenced, and during the months before and after, while LaGrotte paid *all* his rents to the Debtor, and none to Fried.[261] Fried claims those rents "belong" to him, under the race-track lease provision that increases the rent from 12% to 15% if "the *Lessee* operates the food concessions"; he claims he made a gift of the food-concession rents to the Debtor in 1953 and 1954. The "Lessee"—Enterprises—*never* operated the food concessions at the race-track; at all times, Fried licensed LaGrotte or J&J to operate them. There is no good reason to construe the race-track lease liberally in Fried's favor—*i.e.*, to interpret "Lessee" to mean "Lessee's subtenant or sublicensee"—when Fried drew the lease himself and had a conflict of interest at the time of execution. It is notorious that a food concession is often more valuable than the major lease itself; and the state courts, with their looser standards, have prevented percentage-lease differentials and side-deals from working frauds on landlords.[262] Absent a clear writing on the subject here, the race-track food concession was at least an "opportunity" belonging to the Debtor. Weinstein and Fried, the Debtor's managers, neither preserved the "opportunity" for the Debtor nor presented it to the Chapter X court.[263] They simply—and secretly—took it for Fried.

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[261] *Old Colony Trust Co. v. City of Omaha*, 230 U. S. 100, *at* 118 (1913, *per* VAN DEVANTER, *J.*); *N. Y. Central R. Co. v. N. Y., N. H. & Hartford R. Co.*, 24 Misc. 2d 414, 208 N. Y. S. 2d 605, *at* 617-8 (Sup., N. Y. 1960, *per* LORETO, *J.*), *aff'd* 13 A. D. 2d 809, 216 N. Y. S. 2d 928 (1st Dept., 1961, *per* RABIN, *J.*), *aff'd* 11 N. Y. 2d 1077, 230 N. Y. S. 2d 226 (1962); *Town of Islip v. Smith*, 3 A. D. 2d 726, 159 N. Y. S. 2d 763 (2d Dept., 1957, *p. c.*).

[262] *Ricoli Theatre Co., Inc. v. Allison*, 396 Pa. 343, 152 A. 2d 449 (1959, *per* BOK, *J.*); *Hempstead Theatre Corp. v. Metropolitan Playhouses, Inc.*, 6 N. Y. 2d 311, 189 N. Y. S. 2d 837 (1959, *per* FROESSEL, *J.*).

[263] *See Mosser v. Darrow*, 341 U. S. 267 (1951, *per* JACKSON, *J.*); *Donovan & Schuenke v. Sampsell*, 226 F. 2d 804 (9th Cir., 1955, *per* FEE, *J.*, *cert. den.* [*sub nom.*] *Freedman v. Donovan & Schuenke*, 350 U. S. 895 (1955); *In re Bridgeford Co.*, 287 F. 2d 182 (9th Cir., 1956, *per* SOLOMON, *D. J.*).

C. Weinstein and Fried are "fiduciaries" within the comprehension of § 249 and § 221(4).

Congress addressed § 249 to "*any* * * * *person* acting in the proceedings in a representative or *fiduciary* capacity." [264]

1. The words "representative" and "fiduciary" are not defined by the Bankruptcy Act, and comprehend a broad spectrum in equity. Their meaning depends upon *power* and *control*, not titles.

> "* * * * The majority has the right to control; but when it does, it occupies a fiduciary relation toward the minority; as much so as the corporation itself or its officers and directors. * * * *" [265]
>
> "* * * * It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation." [266]

The bankruptcy courts, by statute and in equity, have steadfastly identified "fiduciaries" by their *functions; e.g.:*

> "* * * * There need be no formal relation of trust. *The disability grows out of the duty.* In our opinion the rule of equity should be so broadly applied as to embrace all persons who have a duty to perform with respect to the property of others and with the proper performance of whose duty the character of a purchaser of such property may be in any degree inconsistent." [267]

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[264] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).

[265] *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, *at* 487-8 (1919, *per* BRANDEIS, *J.*).

[266] *Id.*, 250 U. S. *at* 492.

[267] *In re Erazin & Oppenheim*, 181 F. 307, *at* 309 (2d Cir., 1910, *per* NOYES, *J.*), *quoted in Donovan & Schuenke* v. *Campbell*, 226 F. 2d 804, *at* 810 (9th Cir., 1955, *per* FEE, *J.*), *cert. den.* [*sub nom. Freedman* v. *Donovan & Schuenke*], 350 U. S. 895 (1955). *See Pepper* v. *Litton*, 308 U. S. 295 (1939, *per* DOUGLAS, *J.*); *Governor Clinton Co., Inc.* v. *Knott*, 120 F. 2d 149 (2d Cir., 1941, *per* CLARK, *J.*), *cert. dismd.* 314 U. S. 701 (1941).

2. The statutory definitions in the Bankruptcy Act are likewise functional. A Chapter X debtor in possession is a corporate trustee; by statute, its powers and duties are assimilated to those of an individual trustee.[268] Necessarily, and as contemplated by the Bankruptcy Act,[269] much of Chapter X applies to the persons who control the Debtor — an artificial entity; *e.g.*, it is not the debtor in possession, but its officers, who receive compensation for services rendered.

Persons (referred to in § 249) are defined by § 1(23) to include *corporations*, and, in turn—

> "* * * when used with reference to the commission of acts which are forbidden under this Act shall include * * * *agents, officers*, * * *;"[270]

Officer is defined by § 1(22) to include *trustee*, and—

> "* * * the imposing of a duty upon, or the forbidding of an act by, any *officer* shall include * * * any *person* authorized by law to perform the duties of such officer;"[271]

Agent is not defined by the Bankruptcy Act.[272]

3. The orders of September 28, 1953, granting the Debtor's petition for Chapter X relief, provided that the Debtor "by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of" the Debtor (R. 11-12, 15). Subsequent orders increasing Fried's salary were consistent. As

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[268] Bankruptcy Act, § 188, 11 U. S. C. § 588, 52 Stat. 892 (1938); *see* 6 *Collier on Bankruptcy* ¶ 8.10.

[269] *Pursuant to* Bankruptcy Act, § 102, 11 U. S. C. § 102, 52 Stat. 883 (1938), Chapters I *through* VII—including the definitions in § 1—are applicable under Chapter X unless inconsistent. *See* 6 *Collier on Bankruptcy* ¶¶ 1.01-1.12, 2.01-2.03.

[270] Bankruptcy Act, § 1(23); 11 U. S. C. § 1(23); 52 Stat. 840 (1938) (*emphasis supplied*). *See also* Bankruptcy Act, § 7b; 11 U. S. C. § 25b; 52 Stat. 847 (1938).

[271] Bankruptcy Act, § 1(22); 11 U. S. C. § 1(22); 52 Stat. 840 (1938) (*emphasis supplied*).

[272] *See U. S. v. Lynch*, 180 F. 2d 696 (7th Cir., 1950, *per* KERNER, J.), *cert. den.* 339 U. S. 981 (1950).

late as November 7, 1960, the District Judge's Conclusion of Law No. 2 stated: "For having traded in debtor's stock as aforesaid Weinstein's and Fried's management of the debtor should cease" (R. 252). The representations to the Court, made by Weinstein, Fried, and the Debtor's attorney, and upon which the aforesaid orders were made, alleged Fried's joint management with Weinstein, to justify Fried's salary of over $10,000 per year. And so the Debtor has been operated—jointly, by Weinstein and Fried—throughout these proceedings. (*See* pp. 32-33, *supra.*) Fried has been the classic "insider," with actual confidential information and control of the Debtor's business and value, both with respect to the Debtor's stock and the race-track lease and rents. Whether Fried was employed to operate the Debtor's business or to engage in litigation and negotiation relating to allowance of claims and new securities issues; whether Fried was employed by a debtor in possession or by an individual trustee; whether Fried was denominated an "additional trustee" or an "officer" or an "agent" or a "general manager"; whether Fried was paid weekly during the proceedings or in gross at the winding-up; these distinctions are formal only. Fried has been a *de facto* operating co-trustee with Weinstein, with management shared by them and frozen for years by the District Court.

The Bankruptcy Act and the bankruptcy courts forbid self-dealing in the Debtor's stock and in the Debtor's rents. The language of § 249—particularly the words "person" and "fiduciary"—and the language of § 221(4) are sweeping and unqualified. Within § 1(22) and § 1(23), Fried is an "officer" and "agent." Within § 241(3), Fried is an "officer" and "trustee" (*pace* Judge Friendly). Within § 249, he is a "person acting in the proceedings in a representative or fiduciary capacity." Within § 221(4), all payments made to "fiduciaries" must be "reasonable."[273]

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[273] Weinstein and Fried are "representatives" as well as "fiduciaries" under § 249; *see Finn* v. *Childs Co.*, 181 F. 2d 431, *at* 440-1 (2d Cir., 1950, *per* CLARK, *J.*); *cf. Young* v. *Higbee Co.*, 324 U. S. 204 (1945, *per* BLACK, *J.*).

D. The mandatory denial of future compensation out of the estate to Weinstein and Fried, also mandates their removal from office as president and director and as general manager (respectively) of the Debtor.

The Bankruptcy Act contains no explicit provision for removal of directors or officers of a Chapter X debtor in possession. The Court of Appeals did not reach the question (R. 577), though Judge Friendly stated, *obiter*, "we read § 188 as empowering the court to remove him [Philip, as director] if he should [obstruct the operation of the business]" (R. 583).

The District Court, after terminating the future compensation of Weinstein and Fried, barred them from participating in management, as a statutory condition of the Court's continuing the Debtor in possession, under § 188[275] (R. 494-5). However, for supposed lack of power, the District Judge declined to remove Weinstein from office (R. 249), adding the *dictum:*

> "* * * If I had the power, I would remove from office Mr. Weinstein as president because he traded in the stock. But I don't have the power. * * * " (R. 497)

(*See* Conclusion 1, R. 252). The District Judge's findings include:

> "4. The debtor's best interests require that it not be managed by persons serving without compensation." (R. 252)

Fried's "discharge" is more ambiguous. (*See* R. 495, 501-2, 244, 252.)

Evidently, the Court of Appeals disagreed: They permitted Weinstein and Fried to serve without pay for some 16 months, by granting a stay of the District Court's order

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[275] Bankruptcy Act, § 188; 11 U. S. C. § 588; 52 Stat. 892 (1938).

pending appeal; and they found no breach of trust or wrong by Weinstein or Fried (R. 576-7, 582).

The decree "barring Weinstein from participation in management," yet leaving him in office, effectually reduces the number of directors actively serving from three to two. Thus, while the Weinstein-Fried Group retain voting control of the Debtor and its Board, disagreement between Philip and Laupheimer *qua* directors results in one-man rule by Laupheimer *qua* vice-president. Moreover, the decree continues to expose to Weinstein the confidential information about the Debtor which he has already abused by insider trading.[276]

The Chapter X court is authorized, at any time, with or without cause, to terminate the debtor's possession, and to appoint a trustee.[277] Here, the District Judge declined to do so, notwithstanding the "suggestion" by the Court of Appeals (R. 245); and the Court of Appeals has not disturbed that District Court exercise of discretion. Termination of the Debtor's possession would not moot the question presented here; for the Debtor, even if put out of possession, would still represent the stockholders in these proceedings, and the capacity of its directors would remain in issue.[278]

On September 28, 1953, coincident with its continuing the Debtor in possession, the District Court stayed all proceedings against the Debtor in other courts[279] (R. 20). Removal of Weinstein and Fried must be sought in the Chapter X court. Sound discretion would scarcely give leave to proceed

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[276] *See Fells* v. *Katz*, 256 N. Y. 67, 175 N. E. 516 (1931), *per* POUND, *J.*).

[277] Bankruptcy Act, § 159; 11 U. S. C. § 559; 52 Stat. 888 (1938).

[278] *See* 6 *Collier on Bankruptcy* (14th ed.) ¶¶ 8.10, 8.11; *Report of* Percival E. Jackson, Counsel to Special Committee of U. S. Senate to Investigate Bankruptcy and Receivership Proceedings, *etc.*, Sen. Doc. No. 268, 74th Cong., 2d Sess. (1936), *at* 64.

[279] *Pursuant to* Bankruptcy Act, § 116(4); 11 U. S. C. § 516(4); 52 Stat. 885 (1938).

in a Pennsylvania state court, where the Chapter X court has—and is now exercising—exclusive jurisdiction over compensation and surcharge involving the identical facts and the identical parties.

1. *Powers:* The Chapter X court's power to remove directors and officers of a debtor in possession from office for misconduct, derives from both federal and state (Pennsylvania) law, alternatively. Federal law clearly supervenes:

> "§ 188. A debtor continued in possession of its property shall * * * exercise all the powers of a trustee * * *, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe." [280]

However, comity and the Rules of Decision Act [281] require reference to domiciliary (Pennsylvania) law.

(a) As the private business corporation evolved, the law provided for removal of directors and officers for cause. Even in jurisdictions where the only statutory procedure was at "law," by writ of *quo warranto* brought by the state attorney-general (whether or not on a stockholder's relation), [282] concurrent jurisdiction lay in equity where the chancellor had already assumed valid jurisdiction over a corporation and the subject-matter (*e.g.*, in a derivative suit brought against corporate directors for an accounting for fraud, or where a receiver had been appointed). Equity then had the power to

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[280] Bankruptcy Act, § 188; 11 U. S. C. § 588; 52 Stat. 892 (1938).

[281] 28 U. S. C. § 1652, 62 Stat. 944 (1948).

[282] *See* Whyte v. *Faust*, 281 Pa. 444, 127 A. 234 (1924), *per* SCHAFFER, *J.*; *People* v. *Ballard*, 134 N. Y. 269, 32 N. E. 54 (1892), *per* VAN, *J.*, *reary. den.* 130 N. Y. 639, 32 N. E. 611 (1892), *p.* [illegible]; *see also U. S.* v. *Union Pacific R. R. Co.*, 98 U. S. 569 (1879), *per* MILLER, *J.*; *Ames* v. *Kansas*, 111 U. S. 449, *at* 469 (1884), *per* WAITE, *C. J.*; POUND, *Visitorial Jurisdiction over Corporations in Equity*, 49 Harv. L. Rev. 369 (1936).

decree, as "incidental relief," removal of directors and officers for cause.[283]

Now, by statute enacted in Pennsylvania in 1933,[284] equity has plenary jurisdiction over judicial removal of directors for cause. Stockholders having the most direct interest, may sue directly, without joining the attorney-general. Indeed, litigation is the only method to remove directors for cause in a situation like this, where cumulative voting would otherwise perpetuate office-holding. Pennsylvania law[285] and the Debtor's By-Laws[286] permit the board of directors to remove a corporate officer or agent at will, with or without cause. The Debtor's By-Laws are silent as to removal of directors. Pennsylvania law permits stockholders to remove directors at will, with or without cause—but subject to cumulative voting; *i.e.*, if those stockholders opposing removal of an individual director for cause, cast enough votes to have elected him by cumulative voting, then "amotion"[287] fails, and litigation is the only recourse.[288] However, the statute does not condition the accrual of the right of action upon attempted but unsuccessful amotion. The only adjective prerequisites relate to venue, joinder of the corporation, and the plaintiffs' shareholdings of 10% of the stock.[289]

Wolf's counsel has found no federal statutes or cases precisely in point.

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[283] *See Milasinovich* v. *Serbian Progressive Club, Inc.*, 369 Pa. 26, 84 A. 2d 571 (1951, *per* STEARNE, *J.*); *Deal* v. *Miller*, 245 Pa. 1, 90 A. 1070 (1914, *p.c.*); *Welcke* v. *Trageser*, 131 A. D. 731, 116 N. Y. S. 166 (1st Dept., 1909, *per* LAUGHLIN, *J.*).

[284] Pa. Bus. Corp. L. § 405; 15 Purdon's Pa. Stats. Ann. § 2852-405; P. L. 364, Art. IV, § 405 (1933).

[285] Pa. Bus. Corp. L. §§ 405(B), 407; 15 Purdon's Pa. Stats. Ann. §§ 2852-405(B), 407; P. L. 364, Art. IV, §§ 405(B), 407 (1933).

[286] Nazareth By-Laws, Art V, ¶ 3; Saul General Examiner's Exh. I; T. 168 [*not printed*].

[287] *See In re Koch*, 257 N. Y. 318, 178 N. E. 543 (1931 *per* KELLOGG, *J.*).

[288] Pa. Bus. Corp. L. § 405(A), *supra*, n. 284.

[289] Pa. Bus. Corp. L. § 405(C), *supra*, n. 284; *Markovitz* v. *Markovitz*, 336 Pa. 145, 8 A. 2d 46 (1939, *per* BARNES, *J.*).

(b) A debtor—whether or not in possession—must function normally *qua* corporation *during* the reorganization proceedings. Stockholder election of directors under the laws of the debtor's domicile is fundamental.[290] It can function in no other way. Moreover, the judge's own appointment of directors and officers of a debtor in possession, would be tantamount to appointment of trustees, and evasion of the statutory requirement of trustee "disinterestedness."[291] Unless and until the Chapter X court terminates the Debtor's possession here, it must provide stockholders with the rights correlative to election of directors and officers, *viz.:* removal for cause.

(c) Comity permits—and the Rules of Decision Act[292] compels—that the Chapter X court exercise at least the same powers over the Debtor's internal affairs as vested in the Pennsylvania court of common pleas by local statute. There is no inconsistency between state and federal law here. The Chapter X court has general equity jurisdiction. The Debtor is necessarily a party. Wolf holds more than 10% of the Debtor's stock (even under the Court of Appeals' decision in No. 27000). Moreover, he has independent standing as a stockholder, irrespective of the amount of his holdings, in Chapter X proceedings, by statute.[293] The Pennsylvania designation of venue does not oust or bar Chapter X jurisdiction.[294]

The substantive grounds for removal under Pennsylvania law—"fraudulent or dishonest acts, or gross abuse of author-

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[290] *In re J. P. Linahan, Inc.*, 111 F. 2d 596 (2d Cir., 1940, *per* PATTERSON, *J.*); *In re Bush Terminal Co.*, 78 F. 2d 662 (2d Cir., 1935, *per* MANTON, *J.*).

[291] *See* Bankruptcy Act, §§ 156, 158; 11 U. S. C. §§ 556, 558; 52 Stat. 888 (1938).

[292] 28 U. S. C. § 1652; 62 Stat. 944 (1948).

[293] *See* Bankruptcy Act, § 206; 11 U. S. C. § 606; 52 Stat. 894 (1938).

[294] *Mercer County* v. *Cozzles*, 7 Wall. (74 U. S.) 118 (1869, *per* CHASE, *C. J.*); *Chicot County* v. *Sherwood*, 148 U. S. 529 (1893, *per* JACKSON, *J.*).

ity or discretion with reference to the corporation".[295]—subsume the misconduct of directors and officers of a debtor in possession in Chapter X proceedings.

(d) In addition to general provision for equitable cognizance of removal of corporate directors and officers for cause, special provision is made, under the Pennsylvania Business Corporation Law, for honoring bankruptcy decrees that a corporation in reorganization "* * * constitute or appoint directors and officers in place of or in addition to all or some of the directors or officers then in office, * * *."[296]

(e) Apart from Pennsylvania law, the Chapter X court has sufficient statutory power to effect removal of directors and officers for cause. Narrowly, the power can be found in § 191: "* * * No person may become an officer or director of the debtor * * * without the prior approval of the court."[297] Since the District Judge must approve the commencement of service by a director or officer during the proceedings, he may modify or withdraw his earlier order of approval, certainly for cause, in order to "approve" or "control" the continuation of service. Moreover, § 221(5) requires the judge's approval of *prospective* management, even after the winding-up.[298] As contemplated by § 191, the stockholders retain the power of initial election, though subject to judicial veto—continuously.[299]

Broadly, the Chapter X court is vested by statute with the powers of an equity receivership court,[300] and to "Make such orders, * * * in addition to those specifically provided for, as may be necessary for enforcement of the provisions

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[295] Pa. Bus. Corp. L. § 405(C) (*supra*, n. 284).

[296] Pa. Bus. Corp. L. § 320(1), (2); 15 Purdon's Pa. Stats. Ann. § 320(1), (2); P. L. 364, Art. III, § 320(1), (2) (1939).

[297] Bankruptcy Act, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938).

[298] Bankruptcy Act, § 221(5); 11 U. S. C. § 621(5); 52 Stat. 897 (1938).

[299] *See* 6 *Collier on Bankruptcy* (14th Ed.) ¶ 8.15.

[300] Bankruptcy Act, § 115, 11 U. S. C. § 515; 52 Stat. 884 (1938).

of this Act * * * ",[301] and with the general power to exercise its jurisdiction by issuance of necessary writs.[302] If any doubt exists as to the Chapter X court's jurisdiction in equity, it may proceed as though on a writ of *quo warranto*, on Wolf's relation; and, under the modern federal procedure, Wolf's petition in No. 26362 is sufficient therefor.[303]

A serious Constitutional question would arise if the Chapter X court could preempt for itself, exclusively, such powers as a Pennsylvania state court (or federal diversity court) would have with respect to removal of corporate directors and officers for cause, yet deny *all* stockholder rights and remedies in that regard.[304] That question need not be reached here. The statutory "control" over a debtor in possession, and the equitable "visitorial power" over corporations, both vested in the Chapter X court, empower the court to adopt, adapt, and apply the domiciliary (Pennsylvania) law, *and* to "fashion federal law" where Chapter X is not explicit. The rest is a matter of propriety, not power.

2. *Propriety:* The principle underlying the denial of compensation pursuant to both § 249 and § 221(4), is the *Woods* paraphrase of *Paramount-Publix:*

> " * * * 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act." [305]

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[301] Bankruptcy Act, § 2a(15); 11 U. S. C. § 11a(15); 52 Stat. 842 (1938).

[302] All Writs Act, 28 U. S. C. § 1651, 62 Stat. 944 (1948).

[303] *See Continental Ill. Nat. Bank* v. *Chicago, R. I. & P. R. Co.*, 294 U. S. 648, *at* 675-6 (1935, *per* SUTHERLAND, *J.*) [§ 77]; 6 *Moore's Fed. Prac.* ¶ 54.10[5].

[304] *See Brinkerhoff-Faris Trust & S. Co.* v. *Hill*, 281 U. S. 673 (1930, *per* BRANDEIS, *J.*); *Graham* v. *Goodcell*, 282 U. S. 409 (1931, *per* HUGHES, *C. J.*); *Lynch* v. *U. S.*, 292 U. S. 571 (1934, *per* BRANDEIS, *J.*).

[305] *Woods* v. *City National Bank*, 312 U. S. 262, *at* 268 (1941, *per* DOUGLAS, *J.*).

The remedy for disloyalty is drastic. The purpose is preventive and prophylactic; to assure that the managers to whom the Chapter X judge and parties entrust the reorganization and the operation of the debtor's business during the proceedings, conduct themselves in a "disinterested" manner. Here, fiduciary misconduct has come to the attention of the court before the winding-up. To effectuate the purpose of "loyal and disinterested service" during the proceedings still to come, direct judicial removal from office is necessary and proper.[306]

E. The mandate of § 249 and § 221(4) comprehends compensation paid out of the estate in the past, and compels restitution by Weinstein and Fried.

Section 249 simply and absolutely directs, "*No* compensation * * * shall be allowed * * *." Section 221(4) conditions confirmation of a plan upon the "reasonableness" of "*all* payments *made or* promised by the debtor." By contrast, its predecessor, § 77B(f)(5), conditioned confirmation upon the "reasonableness" of "all amounts *to be* paid by the debtor." The *Woods* doctrine is faithful to the statutes. In short, the time of payment of compensation, and the time of application therefor, are irrelevant. If the misconduct occurs at any time during the proceedings, Chapter X prohibits all compensation for all services rendered at any time during the proceedings.

Here, the Debtor's weekly salary checks to Weinstein and Fried were signed by Weinstein as president and countersigned by Referee Joyce, pursuant to the District Judge's authorizing orders (R. 18). The Debtor continued to pay

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[306] *Cf.* 18 U. S. C. (Criminal Code) § 154, 62 Stat. 690 (1948): "* * * Whoever, being a * * * trustee, * * * or other officer of the court, knowingly purchases, directly or indirectly, any property of the estate * * * shall forfeit his office, * * *." *See* 2 *Collier on Bankruptcy* (14th ed.) ¶ 29.13.

those salaries after the occurrence of the misconduct (insider trading and rent diversions), after disclosure thereof to the Court, and after initiation of the proceedings on Wolf's petitions in No. 26362.

The judicial *power* to effectuate recoupment and restitution of moneys previously but improperly paid out of an estate, even under court order, has long been recognized and exercised by the bankruptcy courts, *e.g.*, where the recipient's disqualifying conduct had first been disclosed to the court after the payments were made, and where a court's mistake of law permitted continuation of payments even after disclosure of the disqualifying conduct.[307]

Ordinarily, § 249 and/or § 221(4) would be invoked at the winding-up, after a "fiduciary" had otherwise earned compensation for services already rendered and of value to the estate. Yet, denial of compensation for those years of valuable service, is precisely what Congress contemplated, and mandated. Here, the services were paid for weekly under § 191, instead of in gross at the winding-up. But there is no substantive difference in result: Restoring salaries paid by the Debtor (and perhaps invested wrongfully in the Debtor's stock) is no more penal than forfeiting the expectancy of compensation at the winding-up. Upon restitution, § 191 applicants and § 241 applicants occupy identical positions.

The time of denial of compensation—and the *need* for restitution—depend primarily upon the time of disclosure of the disqualifying conduct and the time of invoking the remedy. Weinstein and Fried themselves concealed their trading

[307] *In re H. L. Stratton, Inc.*, 51 F. 2d 984 (2d Cir., 1931, *per* A. N. HAND, *J.*), *cert. den.* [*sub nom. Jonas & Neuburger v. G. M. A. C.*] 284 U. S. 682 (1932); *In re International Match Corp.*, 190 F. 2d 458 (2d Cir., 1951, *per* A. N. HAND, *J.*), *cert. den.* [*sub nom. Ehrhorn v. International Match Realization Co., Ltd.*] 342 U. S. 870 (1951); *In re Stillwell*, 12 F. 2d 205 (6th Cir., 1926), *per* MOORMAN, *J.*); *In re DeRan*, 260 F. 732 (6th Cir., 1919, *per* KNAPPEN, *J.*).

in the Debtor's stock and their self-dealing in the race-track rents while they continued to draw their salaries. Wolf proceeded derivatively to terminate and recoup those salaries, in default of action by the Debtor (controlled by Weinstein); indeed, the Debtor affirmatively opposed Wolf's petitions in No. 26362. In view of their deliberate wrongdoing, their concealment of those wrongs, their use of the Debtor both to pay their own salaries and to oppose relief in the Debtor's behalf, and their own notice of their liability, there is no "equity" in relieving them of due restitution.

The determination of stock-claims is what this reorganization is all about. For Weinstein and Fried to traffic in those claims themselves at the moment they purport to act for the estate in choosing the good from the bad, is what § 249 aimed to prevent. For 20 years, the Courts of Appeals have rigorously applied § 249 while frequently observing that they viewed the result in particular cases as "harsh" or "tragic"; but the unbending principle, they said, was needed for future cases of willful and subtle self-dealing. The peculiar province of the federal courts having custody of an estate in reorganization, is to preserve that estate against the insider waste and depredation that necessitated the reorganization. This is the case for which § 249 had been so carefully preserved in the Circuits. This is the case for which § 221(4) and *Woods* were intended.

The Court of Appeals insisted that the law permitted the widest discretion; yet, the decisions below are largely *sub silencio*, and especially dubious in an appellate court acting on the cold written word and hot argument. Those *sub silencio* decisions compound the judicial failure below to respect the *objective* standards set for Chapter X fiduciaries by Congress and by this Court. This Court has repeatedly and cogently set forth those objective standards and the reasons for their objectivity. *E.g.:*

> "All the consideration which is paid for a bankrupt's assets becomes part of the estate. No device

or arrangement, however subtle, can subtract or divert any of it. It is the substance of the transaction not its form which governs. If that requirement were not rigidly enforced, control of the plan of reorganization and control of allowances, would pass from the court to the parties. That would subvert the statutory scheme." [308]

"* * * The motives of man are too complex for equity to separate in the case of its trustees the motive of acquiring efficient help from motives of favoring help, for any reason at all or from anticipation of counter-favors later to come. We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for the benefit of others as they would have been on behalf of the trustees himself.

"* * * But equity has sought to limit difficult and delicate fact-finding task concerning its own trustee by precluding such transactions for the reason that their effect is often difficult to trace, and the prohibition is not merely against injuring the estate—it is against profiting out of the position of trust. That this has occurred, so far as the employees are concerned, is undenied.

"* * * The most effective sanction for good administration is personal liability for the consequences of sion' of particular exceptions. * * *" [311]

The uncovering of fiduciary self-dealing demands the indignation of the chancellor, not the sophistication of the market-place.

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[308] *U. S.* v. *Knight*, 336 U. S. 505, *at* 508-9 (1949, *per* DOUGLAS, *J.*) [*conviction for embezzlement under 18 U. S. C. § 153*].

[309] *Mosser* v. *Darrow*, 341 U. S. 267, *at* 272-4 (1951, *per* JACKSON, *J.*) [*trustee surcharged $43,447.46 for employees' profits*].

"* * * Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exception.* * *" [311]

The reorganization legislation and its judicial applications of the 1930s and 1940s came in response to grave social ills. The disease and the purpose of a prophylactic policy may be forgotten when the policy has largely succeeded in arresting the disease. The germ lives, insidiously; witness *Nazareth*. More than a decade has passed since this Court last spoke on the subject of fiduciary compensation in Chapter X proceedings. This case is the occasion to affirm those principles yet again, lest silence from this Court for too long be viewed abroad as enervation and withdrawal.

Conclusion

In No. 27000, the Courts below applied federal rules of decision to a state question—the allowance of claims to stock interests which had vested under state law prior to federal reorganization. In No. 26362, the Courts below applied state rules of decision to a federal question—the administration during reorganization of an estate in the custody of a federal court. In No. 27000, the Courts below re-negotiated investment contracts made prior to the proceedings, without any fraud on the part of the contract-holders. In No. 26362, the Courts below refused to re-negotiate employment contracts made during the proceedings, though shown fraud on the part of the contract-holders. In both cases, the Court of Appeals set up classifications of pre-Chapter X investors and Chapter X employees which were irrational, arbitrary, and capricious. In both cases, the Courts below committed error.

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[311] *Meinhard* v. *Salmon*, 249 N. Y. 458, *at* 464, 164 N. E. 545 (1928, *per* CARDOZO, *C. J.*), *quoted in part in Woods* v. *City National Bank*, 312 U. S. 262, *at* 269 (1941, *per* DOUGLAS, *J.*). *Cf.* Friendly, *Reactions of a Lawyer—Newly Become Judge*, 71 Yale L. J. 218, *at* 237 (1961).

There is still a deeper error committed below in the choice of law. It was the choice of *no-law*; both the Court of Appeals and the District Court, variously in both cases, opted for unlimited judicial "discretion" in "equity." The quintessence of the opinions and decisions below is in Judge Moore's parenthesis: "the terminology is unimportant—the facts create the rights" (R. 592).

What Wolf urges here is not mere terminology, but law. It is *law* that creates the *rights*, here as elsewhere. Of course, litigants expect to be judged by men of decent instincts. Of course, life changes, and with it the law must change. But "rule of law, not rule of men"—a profound truism of our jurisprudence—requires that judges draw a line, somewhere in the gray, short of judgment by hazardous reading of character rather than conduct, short of judgment by nothing but decent instincts. It is justice, not grace, that Wolf prays for. The fundamental principles of Equity, the positive statutes of legislatures, the rulings of this Court—the law that *is*, found, like fact, by hard and humble search—must supersede the unbounded personal views of what should have been. Else, this Court seals a tyranny—and no less a tyranny for being judicial or ostensibly benevolent.

For the foregoing reasons, Petitioners Wolf *et al.* respectfully submit that the following relief should be granted by this Court:

No. 27000

1. Decretal paragraph 1 of the District Court's Judgment dated December 8, 1960, and entered December 9, 1960 (R. 262-3) should be modified to read as follows:

> "1. That each of the 36 stock-claimants hereafter named is the owner of shares of stock of Nazareth Fair Grounds & Farmers' Market, Inc., the Debtor herein, in such proportion to the total authorized issue

of 200 shares as his or her respective shares of stock (as represented by stock certificates outstanding and held by him or her) bears to the total outstanding issue of 262 shares of said Debtor's stock now held by said 36 stock-claimants in the aggregate; and, to that extent, each is deemed to be a stockholder of said Debtor for all purposes in the within reorganization proceeding, and is entitled to shares of stock of the Debtor calculated on that basis, *viz.:* Charles Kanter, 40/262; Morton Samet, 2/262; Gertrude Klein, 14/262; Dorothy Holober Clark, 3/262; Barry Clark, 4/262; Harold Q. Masur, 4/262; Louis Como, 6/262; Frank Como, 6/262; Patsy Como, 8/262; Anne Bikales, 5/262; Lawrence Treat, 2/262; Dorothy Kane, 3/262; Miriam Klein, 4/262; Ruth Spielholz, 3/262; Mae Bluestone, 2/262; Gussie Schwartz, 2/262; Harold B. Schwartz, 4/262; Lazar Karapontso, 2/262; Ernest Pollak, 9/262; H. Lawrence Laupheimer, 8/262; Arnold A. Weinstein, 7/262; Aaron Fried, 3/262; George Bond, 1/262; Tess J. Schwartz, 3/262; Cydney Grossman, 2/262; Rose Kaplan, 1/262; Robert A. Noire, 5/262; Harry Forman, 10/262; Richard S. Hull, 6/262; Herbert and Melvin Danciger, 11/262; Leslie Saul, 3/262; Jerome Fried, 3/262; Seymour Forman, 15/262; Eskander Manoochehrian, 20/262; Ann Rosen, 6/262; Frederick Katzenell, 35/262."

2. Decretal paragraphs 2, 3, 4, 5, and 6 of the District Court's aforesaid Judgment (R. 263-4) should be *affirmed*.

3. The Court of Appeals' Judgment, dated and entered November 9, 1961 (R. 600-1), should be *reversed* and *vacated*.

No. 26362

1. Arnold A. Weinstein and Jerome Fried should be removed from their respective offices as President and Director and as General Manager of Nazareth Fair Grounds & Farmers' Market, Inc., the Debtor herein, and should be barred from holding office as directors or officers or managers during the pendency of these reorganization proceedings.

2. Arnold A. Weinstein and Jerome Fried should be denied all compensation and reimbursement of expenses from said Debtor during the pendency of these reorganization proceedings.

3. Arnold A. Weinstein and Jerome Fried should severally account to the Chapter X court for all compensation and reimbursement of expenses received by them from said Debtor for the period from and after September 28, 1953; and each of them should restore to the Debtor, and the Debtor should recoup from each of them, all such compensation and reimbursement of expenses.

4. So much of the Court of Appeals' Judgment, dated and entered November 9, 1961 (R. 584-5), which reversed the District Court's Judgment dated June 14, 1960, and entered June 27, 1960 (R. 494-6), should be *reversed* and vacated.

Dated: New York, New York,
November 26, 1962.

Respectfully submitted,

MELVIN LLOYD ROBBINS,
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New York 16, N. Y.

APPENDIX A

Abstract of Federal Income Tax Returns and Accounting of Nazareth Enterprises, Inc.*

1953:	(a)	Gross spectator admissions	$ 48,243.92
	(b)	LaGrotte rents collected	0.00
	(c)	Net profit (loss)	(12,286.35)
	(d)	Rent to Debtor paid	5,668.27
	(e)	Net rents	5,668.27
1954:	(a)	Gross spectator admissions	$ 56,066.38
	(b)	J&J rents collected	875.65
	(c)	Net profit (loss)	(884.75)
	(d)	Rent to Debtor paid	6,503.60
	(e)	Net rents	5,627.95
1955:	(a)	Gross spectator admissions	$ 45,827.02
	(b)	J&J rents collected	4,346.62
	(c)	Net profit (loss)	(941.57)
	(d)	Rent to Debtor paid	5,946.22
	(e)	Net rents	1,599.60
1956:	(a)	Gross spectator admissions	$ 49,300.74
	(b)	J&J rents collected	3,638.92
	(c)	Net profit	1,074.15
	(d)	Rent to Debtor paid	5,708.64
	(e)	Net rents	2,069.72
1957:	(a)	Gross spectator admissions	$ 58,611.93
	(b)	J&J rents collected	4,606.48
	(c)	Net profit	7,026.18
	(d)	Rent to Debtor paid	6,638.53
	(e)	Net rents	2,032.05
1958.	(a)	Gross spectator admissions	$ 55,871.09
	(b)	J&J rents collected	3,348.66
	(c)	Net profit	3,700.36
	(d)	Rent to Debtor paid	5,852.11
	(e)	Net rent	2,503.45
1959:	(a)	Gross spectator admissions	$ 90,315.32
	(b)	J&J rents collected	5,235.62
	(c)	Net profit	2,334.53
	(d)	Rent to Debtor paid	9,300.36
	(e)	Net rent	4,064.74
1960:	(a)	Gross spectator admissions	$107,199.63
	(b)	J&J rents collected	7,245.35
	(c)	Net profit	?
	(d)	Rent to Debtor paid	11,224.07
	(e)	Net rent	3,978.72
1961:	(a)	Gross spectator admissions	$122,363.76
	(b)	J&J rents collected	?
	(c)	Net profit	?
	(d)	Rent to Debtor paid	12,663.07
	(e)	Net rent	?

Appendix A

* **Notes to Abstract.** (*See* Record on Pet. for Cert., No. 26302, vol. III.)

The information shown is obtained from: (1) Accounting of Nazareth Enterprises, Inc., dated and verified (by Jerome Fried, as President) on January 9, 1962, and filed in the District Court for the Southern District of New York on January 10, 1962; (2) Enterprises' federal income tax returns (J. Fried Creditor: Debtor's Exhs. AB, AC, AD, AE, AF; Wolf's Exhs. 45, 46); (3) Enterprises' journals and ledgers (J. Fried Creditor: Cl.'s Exh. 7; Wolf's Exhs. 47, 48); and (4) Gilbert Sunshine's testimony (S. M. 11/18/60, 11788-99), based on his worksheets and the aforesaid records. Mr. Sunshine is Enterprises' accountant; he is also the accountant for the Debtor and for J&J Foods, Inc. (S. M. 1/26/60, 10051-3, 10062-4). He prepared the tax returns, and supervised the Enterprises bookkeeping. (The testimony and exhibits and Accounting referred to, have not been printed.)

This Abstract shows: (a) Gross spectator admissions at the Enterprises box-office (excluding taxes and the back-gate receipts); (b) Rents collected by Enterprises from LaGrotte and J&J; (c) Net taxable operating profit (or loss), earned (or incurred) by Enterprises; (d) Percentage rents paid by Enterprises to the Debtor; (e) Net rents (i.e., difference between (d) Enterprises rents paid to the Debtor, and (b) rents collected by Enterprises from LaGrotte and J&J). The years shown are the calendar years 1953 through 1961; the Enterprises annual racing season (except for Tuesday "drag races") extends from about May 1 to October 31.

Enterprises' fiscal year runs from March 1 to February 28. The tax return for fiscal 1961 (3/1/60-2/28/61) is not in evidence.

No federal income tax was paid by Enterprises from fiscal 1954 through fiscal 1959 (inclusive): In fiscal 1954, 1955, and 1956, Enterprises showed net losses; and in fiscal 1957, 1958, and 1959, the loss carry-forward consumed the net operating profits shown. Enterprises paid federal income tax of $6.77 for fiscal 1960.

In fiscal 1954 and 1960, Fried received $1,500 and $5,200 (respectively) from Enterprises as officer's compensation. No such compensation to Fried is shown for fiscal 1955 through 1959 (inclusive).

Enterprises' federal income tax for fiscal 1954 (J. Fried creditor: Debtor's AC) shows "netted rents" (i.e., the difference between the rent paid by Enterprises to the Debtor, and the rent collected by Entrprises from J&J (S. M. 11/18/60, 11845-52). If this practice had been followed on later Enterprises' returns, then item (e) "Net rents" would have appeared on these returns, instead of both item (d) Rent to Debtor paid, and item (b) J&J rent collected (*see* S. M. 11/18/60, 11789).

Appendix A

In the calendar years 1958 and 1959, J&J paid Enterprises, in rent, 15% of its (J&J's) gross receipts on its race-track food concession sales of $15,260.08 and $19,385.78 (respectively) (Wolf's 26), which equalled $2,289.01 and $2,907.87 (respectively) (S. M. 10455-8). The tax returns show that Enterprises collected $3,348.66 and $5,235.62 in "rents" from J&J in 1958 and 1959 (respectively). The difference arises from Enterprises' 50% share of J&J's net profit on its race-track sales (S. M. 11/18/60, 11769-70, 11871-5, 11913-7), which equalled $1,059.65 and $2,327.75 in 1958 and 1959 (respectively).

Following is a tabulation of the "Gate," the gross spectator admissions at the Enterprises box-office (excluding taxes and the back-gate receipts), and the actual percentage rents paid by Enterprises to the Debtor, and a computation of rents at 12% and 15% of the "Gate":

	Gate	*12%*	*15%*	*Actual*	*Actual*
1953	$ 48,243.92	$ 5,789.27	$	$ 5,668.27	11.749%
1954	56,066.38	6,727.97	8,409.96	6,503.50	11.560%
1955	45,827.02	5,499.24	6,874.05	5,946.22	12.975%
1956	49,300.74	5,915.09	7,395.11	5,708.64	11.579%
1957	58,611.93	7,033.43	8,791.79	6,638.53	11.326%
1958	55,871.09	6,704.53	8,380.66	5,852.11	10.474%
1959	90,315.32	10,837.84	13,547.30	9,300.36	10.298%
1960	107,199.63	12,863.96	16,079.94	11,224.07	10.470%
1961	122,363.76	14,863.65	18,354.56	12,663.07	10.349%
Total (1954-61)	$585,555.87	$70,265.71	$87,833.37	$63,836.50	10.902%

Appendix A

Following is a tabulation of the amounts which would be *due* from Enterprises to the Debtor, under the Enterprises lease: (a) if Enterprises were required to pay over to the Debtor the J&J rents which Enterprises collected, *and* to pay the Debtor rent at 12%; and, (b) if Enterprises were permitted to retain the J&J rents it collected, but if Enterprises were required to pay the Debtor rent at 15%:

	(a) 12% + J&J	*Due*	*(b) 15%*	*Due*
* 1954	$ 7,603.62	$ 1,100.02	$ 8,409.96	$ 1,906.36
1955	9,845.86	3,899.64	6,874.05	927.83
1956	9,555.01	3,846.37	7,395.11	1,686.47
1957	11,639.91	5,001.38	8,791.79	2,153.26
1958	10,053.49	4,201.08	8,380.66	2,528.55
1959	16,073.46	6,773.10	13,547.30	4,246.94
1960	20,109.31	8,885.24	16,079.94	4,855.87
1961	?	?	18,354.56	5,691.49
Total	$84,880.36	$33,706.83	$87,833.37	$23,996.77

* Enterprises collected the J&J race-track food-concession rents for only part of 1954. However, Sunshine is unable to break down the totals or to ascertain when in 1954 the change was made. (S. M. 11/18/60, 11795-9, 11845-51.)

APPENDIX B

Text of Statutes Cited

Bankruptcy Act, §§ 1(22), 1(23); 11 U.S.C. §§ 1(22), 1(23); 52 Stat. 840 (1938):

§ 1. *Meaning of Words and Phrases*

The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: * * *

(22) "Officer" shall include clerk, marshal, receiver, custodian, referee, and trustee, and the imposing of a duty upon, or the forbidding of an act by, any officer shall include his successor and any person authorized by law to perform the duties of such officer;

(23) "Persons" shall include corporations, except where otherwise specified, and officers, partnerships, and women, and when used with reference to the commission of acts which are forbidden under this Act shall include persons who are participants in the forbidden acts, and the agents, officers, and members of the board of directors or trustees or of other similar controlling bodies of corporations; * * *.

Bankruptcy Act, § 2a(15); 11 U.S.C. § 11a(15); 52 Stat. 842 (1938):

§ 2. *Creation of courts of bankruptcy and their jurisdiction*

a. The courts of the United States hereinbefore defined as courts of bankruptcy are created courts of bankruptcy and are invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * *

(15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this title: *Provided, however*, That an injunction to restrain a court may be issued by the judge only.

* * *

Bankruptcy Act, § 7b; 11 U.S.C. § 25b; 52 Stat. 847 (1938):

§ 7. *Duties of bankrupts*

a. * * *

b. Where bankrupt is a corporation, its officers, the members of its board of directors or trustees or of other similar controlling bodies, its stockholders or members, or such of them as may be designated by the court, shall perform the duties imposed upon the bankrupt by this title.

Bankruptcy Act, § 115, 11 U.S.C. § 515; 52 Stat. 884 (1938):

§ 115. *Same; Jurisdiction as in Insolvency*

Upon the approval of a petition, the court shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.

Appendix B

Bankruptcy Act, § 116; 11 U.S.C. § 516; 52 Stat. 885 (1938):

§ 116. *Same; Additional Jurisdiction over Administration of Estate* —

Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court—

(1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice to the parties to such contracts and to such other parties in interest as the judge may designate;

(2) authorize a receiver, trustee, or debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to issue certificates of indebtedness for cash, property, or other consideration approved by the judge, upon such terms and conditions and with such security and priority in payment over existing obligations, secured or unsecured, as in the particular case may be equitable;

(3) authorize a receiver or a trustee or a debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to lease or sell any property of the debtor, whether real or personal, upon such terms and conditions as the judge may approve; and

(4) in addition to the relief provided by section 11 [11 U. S. C. § 29] of this Act, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.

(5) * * *

Appendix B

Bankruptcy Act, § 156; 11 U.S.C. § 356; 52 Stat. 888 (1938):

§ 156. *Appointment of Trustees; Continuance of Debtor in Possession*

Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed, the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.

Bankruptcy Act, § 157; 11 U.S.C. § 357; 52 Stat. 888 (1938):

§ 157. *Attorney for Trustee*

An attorney appointed to represent a trustee under this chapter shall also be a disinterested person: *Provided, however,* That for any specified purposes other than to represent a trustee in conducting the proceeding under this chapter the trustee may, with the approval of the judge, employ an attorney who is not disinterested.

Bankruptcy Act, § 158; 11 U.S.C. § 358; 52 Stat. 888 (1938):

§ 158. *Interest of Persons*

A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this Act, if—

(1) he is a creditor or stockholder of the debtor; or

(2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

(4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

Bankruptcy Act, § 159; 11 U.S.C. § 559; 52 Stat. 888 (1938):

§ 159. *Termination of trustee's appointment or debtor's possession.*

Where the indebtedness of a debtor is less than $250,000, the judge may at any time terminate the appointment of a trustee and restore the debtor to the possession of its property, or, if the debtor has been continued in possession, terminate its possession and appoint a trustee.

Bankruptcy Act, § 160; 11 U.S.C. § 560; 52 Stat. 888 (1938):

§ 160. *Appointment of additional trustees; removal and substitution of trustees.*

In any case, the judge at any time, without or upon cause shown, may appoint additional trustees or remove trustees and appoint substitute trustees.

Appendix B

Bankruptcy Act § 167; 11 U.S.C. § 567; 52 Stat. 890 (1938):

§ 167. *Powers and duties; trustee.*

The trustee upon his appointment and qualification—

(1) shall, if the judge shall so direct, forthwith investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge;

(2) may, if the judge shall so direct, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters or any of them;

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate;

(4) may, subject to the approval of the judge, employ such person or persons as the judge may deem necessary for the purpose of assisting the trustee in performing the duties imposed upon him under this chapter;

(5) shall, at the earliest date practicable, prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, in such form and manner as the judge may direct, to the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate; and

(6) shall give notice to the creditors and stockholders that they may submit to him suggestions for the formulation of a plan, or proposals in the form of plans, within a time therein named.

Bankruptcy Act, § 168; 11 U.S.C. § 568; 52 Stat. 890 (1938):

§ 168. *Same; Disinterested Person Where Debtor is in Possession*

If a debtor is continued in possession, the judge may at any time appoint a disinterested person as examiner to prepare and file a plan and to perform the duties imposed upon a trustee under paragraphs (1) to (5) inclusive, of section 167 of this Act, or to perform any of such duties.

Bankruptcy Act, § 188; 11 U.S.C. § 588; 52 Stat. 892 (1938):

§ 188. *Debtor in possession; title, rights, duties, and powers*

A debtor continued in possession of its property shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe.

Bankruptcy Act, § 191; 11 U.S.C. § 591; 52 Stat. 893 (1938):

§ 191. *Employment of Officers of Debtor*

A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court.

Appendix B

Bankruptcy Act, § 196; 11 U.S.C. § 596; 52 Stat. 893 (1938):

§ 196. *Filing and Allowing Proofs of Claims; Objections to Allowances*

After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the Court.

Bankruptcy Act § 206; 11 U.S.C. § 606; 52 Stat. 894 (1938):

§ 206. *Persons entitled to hearings.*

The debtor, the indenture trustees, and any creditor or stockholder of the debtor shall have the right to be heard on all matters arising in a proceeding under this chapter. The judge may, for cause shown, permit a labor union or employees' association, representative of employees of the debtor, to be heard on the economic soundess of the plan affecting the interests of the employees.

Bankruptcy Act § 210; 11 U.S.C. § 610; 52 Stat. 895 (1938):

§ 210. [*Representation in Proceedings*]; *statement by attorney.*

An attorney for creditors or stockholders shall not be heard unless he has first filed with the court a statement setting forth the names and addresses of such creditors or stockholders, the nature and amounts of their claims or stock, and the time of acquisition thereof, except as to claims or stock alleged to have been acquired more than one year prior to the filing of the petition.

Appendix B

Bankruptcy Act, § 212; 11 U.S.C. § 612; 52 Stat. 895 (1938):

§ 212. *Same; Regulation by Court*

The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor.

Bankruptcy Act, § 221(4); 11 U.S.C. § 621(4); 52 Stat. 897 (1938):

§ 221. *Confirmation by Court*

The judge shall confirm a plan if satisfied that— • • •

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; • • •.

Appendix B

Bankruptcy Act § 241; 11 U.S.C. § 641; 52 Stat. 900 (1938):

§ 241. *Petitioning creditors; court officers; attorneys therefor.*

The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustee shall not be governed by sections 40 and 48 [11 U. S. C. §§ 68 and 76] of this Act.

Bankruptcy Act, § 247; 11 U.S.C. § 647; 52 Stat. 901 (1938):

§ 247. *Hearing of applications*

The judge shall fix a time of hearing for the consideration of applications for allowances, of which hearing notice shall be given to the applicants, the trustee, the debtor, the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate, ***. ***

Bankruptcy Act, § 249; 11 U.S.C. § 649; 52 Stat. 901 (1938):

§ 249. *Statement of Claims or Stock Acquired or Transferred after Commencement of Proceeding*

Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a state-

ment under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

Amendatory Act, § 5b; Additional Provisions of the Act of June 22, 1938 (The Chandler Act, ch. 575, 52 Stat. 840), § 5b; 11 U.S.C. § 1, notes:

§ 5. *Severability; Headings*

• • •

b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate.

Bankruptcy Act, § 77B(b); 11 U.S.C. § 207(b); 48 Stat. 915 (1934) [*Repealed*]:

§ 77B(b) [*Repealed*]. A plan of reorganization within the meaning of this section • • •: *Provided*, That the judge shall scrutinize and may disregard any limitations or provisions of any depositary agreements, trust indentures, committee or other authorizations affecting any creditor acting under this section and may enforce an accounting thereunder or restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claims filed by such committee member or agent, to the actual consideration paid therefor. • • •

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Bankruptcy Act, § 77B(c): 11 U.S.C. § 207(c): 48 Stat. 912 (1934) [*Repealed*]:

§ 77B(c) [*Repealed*] Upon approving the petition or answer or at any time thereafter, the judge, in addition to the jurisdiction and powers elsewhere in this section conferred upon him, * * *

(9) may allow a reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses *incurred* in connection with the proceeding and the plan by officers, parties in interest, depositaries, reorganization managers and committees or other representatives of creditors or stockholders, and the attorneys or agents of any of the foregoing and of the debtor, but appeals from orders fixing such allowances may be taken to the Circuit Court of Appeals independently of other appeals in the proceeding and shall be heard summarily; * * *

While the debtor is in possession (a) its officers shall be entitled to receive only such reasonable compensation as the judge shall from time to time approve, and (b) no person shall be elected or appointed to any office, to fill a vacancy or otherwise, without the prior approval of the judge.

Bankruptcy Act, § 77B(f)(5): 11 U.S.C. §207(f)(5): 48 Stat. 912 (1934):

§ 77B(f) [*Repealed*] After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that * * *

(5) all amounts to be paid by the debtor or by any corporation or corporations acquiring the debtor's assets, and all amounts to be paid to committees or reorganization

managers, whether or not by the debtor or any such corporation for services or expenses incident to the reorganization, have been fully disclosed and are reasonable, or are to be subject to the approval of the judge; * * *.

Securities Exchange Act of 1934, § 16(b); 15 U.S.C. § 78p(b); 48 Stat. 896 (1934):

§ 16. *Directors, officers, and principal stockholders.*

(a) * * *

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or official by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase

and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

(c) * * *

18 U.S.C. [Criminal Code] § 153; 62 Stat. 690 (1948):

§ 153. *Embezzlement by trustee, receiver or officer.*

Whoever knowingly and fraudulently appropriates to his own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a bankrupt which came into his charge as trustee, receiver, custodian, marshal, or other officer of the court, shall be fined not more than $5,000 or imprisoned not more than five years, or both.

18 U.S.C. [Criminal Code] § 154; 62 Stat. 690 (1948):

§ 154. *Adverse interest and conduct of referees and other officers.*

* * *

Whoever, being a referee, receiver, custodian, trustee, marshal, or other officer of the court, knowingly purchases, directly or indirectly, any property of the estate of which he is such officer in a bankruptcy proceeding;

* * *

Shall be fined not more than $500, and shall forfeit his office, which shall thereupon become vacant.

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28 U.S.C. § 1651; 62 Stat. 944 (1948), *amended* 63 Stat. 102 (1949):

§ 1651. *Writs*

(a) The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.

(b) An alternative writ or rule nisi may be issued by a justice or judge of a court which has jurisdiction.

28 U.S.C. § 1652; 62 Stat. 944 (1948):

§ 1652. *State laws as rules of decision*

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in *civil actions* [trials at common law] in the courts of the United States, in cases where they apply. [*Italicized words substituted for bracketed words* by 1948 amendment to Judiciary Act of 1789, § 34; 1 Stat. 92, Rev. Stat. § 721, 28 U. S. C. [1940 ed.] § 725.]

Rules 1, 2, 52(a), 81(a)(1), Fed. Rules of Civ. Proc., *f.* 28 U.S.C. § 2072:

Rule 1. *Scope of Rules.*

These rules govern the procedure in the United States district courts in all suits of a civil nature whether cognizable as cases at law or in equity, with the exceptions stated in Rule 81. They shall be construed to secure the just, speedy, and inexpensive determination of every action.

Rule 2. *One Form of Action.*

There shall be one form of action to be known as "civil action."

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Rule 52. ***Findings by the Court***

(a) EFFECT. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

Rule 81. ***Applicability in General.***

(a) *To What Proceedings Applicable.*

(1) These rules do not apply to proceedings in admiralty. They do not apply to proceedings in bankruptcy or proceedings in copyright under Title 17, U.S.C., except in so far as they may be made applicable thereto by rules promulgated by the Supreme Court of the United States. They do not apply to probate, adoption, or lunacy proceedings in the United States District Court for the District of Columbia except to appeals therein.

* * *

Appendix B

General Orders in Bankruptcy

37.—General Provisions

In proceedings under the Act the Rules of Civil Procedure for the District Courts of the United States shall, in so far as they are not inconsistent with the Act or with these general orders, be followed as nearly as may be. But the court may shorten the limitations of time prescribed so as to expedite hearings, and may otherwise modify the rules for the preparation or hearing of any particular proceeding.

Pa. Constitution, Art. XVI, § 7 (1874):

§ 7. *Stocks and bonds; increase of indebtedness*

No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock and indebtedness of corporations shall not be increased except in pursuance of general law, *nor without the consent of the persons holding the larger amount in value of the stock, first obtained at a meeting to be held after sixty days notice in pursuance of law.* [*Italicized words deleted by 1956 amendment.*]

Pa. Bus. Corp. L. § 302(8); 15 Purdon's Pa. Stats. Ann. § 2852-302(8); P.L. 364, Art. III, § 302(8) (1933), amended by P.L. 711, § 1 (1957):

§ 302. *General powers*

Subject to the limitations and restrictions contained in this act or in its articles, every business corporation shall have power:

• • •

(8) To borrow money for any or all of the purposes for which it is organized, to issue its promissory notes, bonds, or

other forms of certificates of indebtedness, [for the repayment thereof, with interest] *for money, labor done, or money or property, including shares of the corporation properly acquirable by it under this act, actually received* and to secure any of its obligations by mortgage, pledge, or deed of trust of, or on, any of its property, franchises and income.

[*Italicized words added, and bracketed words deleted, by 1957 amendment.*]

Pa. Bus. Corp. L. § 320(1), (2): 15 Purdon's Pa. Stats. Ann. § 2852-302(1), (2); P.L. 364, Art. III, § 320(1), (2) (1933), *added* P.L. 698, § 1 (1939), *amended* P.L. 711, § 1 (1957):

§ 320. *Arrangement, and reorganization under National Bankruptcy Act*

(1) Any business corporation having a plan of reorganization or an arrangement which, pursuant to the provisions of the Act of Congress of July first, one thousand eight hundred and ninety-eight, entitled "An act to establish a uniform system of bankruptcy throughout the United States," as amended and supplemented, or of any similar Act of Congress (said act and such acts being herein referred to as the National Bankruptcy Act), has been or shall be confirmed by the decree or order of a court of competent jurisdiction, shall have full power and authority to put into effect and carry out the plan or arrangement and the decrees and orders of the court, or judge or referee relative thereto, and may take any proceeding and do any act provided in the plan or arrangement or directed by such decrees and orders, without further action by its directors or shareholders. Such power and authority may be exercised, and such proceedings and acts may be taken, as may be directed by such decrees or orders, by the trustee or trustees, or receiver or receivers, of such corporation appointed in the bankruptcy proceed-

ings (or a majority thereof), or if none be appointed and acting, by designated officers of the corporation, or by a master or other representative appointed by the court or judge or referee, with like effect as if exercised and taken by unanimous action of the directors and shareholders of the corporation [but a business corporation shall not increase its indebtedness or its authorized capital stock except after the approval of such increase at a meeting of its shareholders held in accordance with the provisions of this act].

(2) Such corporation may, in the manner above provided, but without limiting the generality or effect of the foregoing, alter, amend, or repeal its by-laws; constitute or reconstitute and classify or reclassify its board or directors, and name, constitute or appoint directors and officers in place of or in addition to all or some of the directors or officers then in office; amend its articles of incorporation, and make any change in its stated capital [or authorized capital stock], or any other amendment, change, alteration, or provision, authorized by this act, including the cancellation of any or all authorized classes of shares, whether or not any shares thereof are outstanding; be dissolved, transfer all or part of its assets, merge or consolidate as permitted by this act, in which case, however, no shareholder shall have any statutory right of appraisal of his shares; change the location of its principal office; authorize and fix the terms, manner and conditions of the issuance of bonds, debentures or other obligations, whether or not convertible into [stock] *shares* of any class, or bearing warrants or other evidences of optional rights to purchase or subscribe for [stock] *shares* of any class; or lease its property and franchises to any corporation, if permitted by law.

* * *

[*Italicized words added, and bracketed words deleted, by 1957 amendment.*]

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Pa. Bus. Corp. L. § 405; 15 Purdon's Pa. Stats. Ann. § 2852-405; P.L. 364, Art. IV, § 405 (1933):

§ 405. *Removal of directors*

A. The entire board of directors or any individual director may be removed from office without assigning any cause by a majority vote of the holders of the outstanding shares entitled to vote at an election of directors. In case the board or any one or more directors be so removed, new directors may be elected at the same meeting. Unless the entire board be removed, no individual director shall be removed in case the votes of a sufficient number of shares are cast against the resolution for his removal, which if cumulatively voted at an election of the full board would be sufficient to elect one or more directors.

B. The board of directors may declare vacant the office of a director if he be declared of unsound mind by an order of court, or convicted of felony, or for any other proper cause, or if, within sixty days or such other time as the by-laws may specify, after notice of his election, he does not accept such office either in writing or by attending a meeting of the board of directors and fulfill such other requirements of qualification as the by-laws may specify.

C. The court of common pleas of the county where the registered office of the corporation is located may at the suit of any shareholder or shareholders holding at least ten per cent of the common or outstanding shares, with or without voting rights, remove from office any director or directors in case of fraudulent or dishonest acts, or gross abuse of authority or discretion with reference to the corporation, and may bar from re-election any director so removed for a period prescribed by the court. The corporation shall be made a party to such actions.

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Pa. Bus. Corp. L. § 407; 15 Purdon's Pa. Stats. Ann. § 2852-407; P.L. 364, Art. IV, § 407 (1933):

§ 407. *Removal of officers*

Any officer or agent elected or appointed by the board of directors may be removed by the board of directors whenever in its judgment the best interests of the corporation will be served thereby, but such removal shall be without prejudice to the contract rights, if any, of the person so removed.

Pa. Bus. Corp. L. § 408; 15 Purdon's Pa. Stats. Ann. § 2852-408; P.L. 364, Art. IV, § 408 (1933):

§ 408. *Relation of directors and officers to corporation*

Officers and directors shall be deemed to stand in a fiduciary relation to the corporation, and shall discharge the duties of their respective positions in good faith and with that diligence, care and skill which ordinary prudent men would exercise under similar circumstances in their personal business affairs.

Pa. Bus. Corp. L. § 603A; 15 Purdon's Pa. Stats. Ann. § 2852-603A; P.L. 364, Art. VI, § 603A (1933), *amended by* P.L. 711, § 1 (1957):

§ 603. *Consideration for shares*

A. Shares of a business corporation shall not be issued except for money, labor done, or money or property actually received. Subscriptions for shares having a par value shall be made payable with money to an amount not less than the aggregate par value of the shares subscribed for or with consideration other than money, the fair value of which to the corporation is not less than the aggregate par value of the

shares subscribed for. Subscriptions for shares having no par value, which are made before incorporation, shall be made payable with consideration of the character and value determined by the incorporators. Subscriptions for shares having no par value, which are made after incorporation, shall be made payable with consideration of the character and value determined by the shareholders at any annual or special meeting duly called and held for that purpose, or determined by the board of directors, acting under authority conferred by the shareholders or by the articles of the corporation. Shares of a corporation issued and thereafter acquired by it may be disposed of by the corporation for such consideration as may be fixed from time to time by the board of directors. For the purpose of determining whether shares have been fully paid for, in order to fix the extent of the outstanding obligation of a shareholder to the corporation with respect to such shares, the value placed by the incorporators, the shareholders, or the board of directors, as the case may be, upon the consideration, other than cash, with which the subscriptions for shares are made payable, shall be conclusive.

* * *

Pa. Bus. Corp. L. § 604; 15 Purdon's Pa. Stats. Ann. § 2852-604; P.L. 364, Art. VI, § 604 (1933):

§ 604. *Payment of Subscriptions for Shares*

Unless otherwise provided in the subscription agreement, subscriptions for shares, whether made before or after the organization of a corporation, shall be paid in full at such time, or in such installments and at such times, as shall be determined by the board of directors. Any call made by the board of directors for payment of subscriptions shall be uniform as to all shares of the same class, or as to all shares of the same series, as the case may be. The director shall cause notice of the amount of any call, and of the time and place

of payment, to be given at least thirty days before the date the call is due, either personally or by mail addressed to each shareholder at his last address, as it appears on the books of the corporation. If a shareholder be indebted to a business corporation on account of unpaid subscriptions for shares, the corporation shall have a lien upon such shares for such indebtedness. Shares for which the agreed consideration has been paid, delivered, or rendered to the corporation shall be fully paid shares and non-assessable. No note or obligation given by a shareholder, whether secured by pledge or otherwise, shall be considered as payment, in whole or in part, of any shares of a business corporation.

Pa. Bus. Corp. L. § 605; 15 Purdon's Pa. Stats. Ann. § 2852-605; P.L. 364, Art. VI, § 605 (1933):

§ 605. *Defaults in Payment of Consideration for Shares*

When any shareholder fails to pay any call upon his shares properly made by the directors, at the time when such payment is due, the directors may proceed to collect the amount due in the same manner as any debt due the corporation, or they may sell, at public sale, such part of the shares of the delinquent shareholder as will pay all or any part of the installments then due from him, with interest and all incidental expenses, and transfer the shares so sold to the purchaser, who shall be entitled to a certificate therefor. Notice of the time and place of such sale, and of the sum due on each share, shall be given by advertisement, once a week for two consecutive weeks next preceding the date fixed for the sale, in a newspaper of general circulation published in the county where the corporation has its registered office and in the legal newspaper, if any, designated by the rules of court for the publication of legal notices in such county, or, if there be no newspaper of

general circulation published in such county, then in a newspaper of general circulation in such county, and such notice shall be mailed by the treasurer of the corporation to the delinquent shareholder, at his last known post office address, at least twenty days before the date fixed for such sale. If no bidder can be had to pay the amount due on the shares, or if the amount is not collected by an action at law brought within the county where such corporation has its registered office, the shares shall be forfeited to the corporation, and the amount previously paid in by the delinquent shareholder on the shares shall be forfeited to the corporation. Such shares, if forfeited, may be reissued or reoffered for subscription by the corporation. No share shall be voted at any meeting upon which any installment is due and unpaid.

Pa. Bus. Corp. L. § 609: 15 Purdon's Pa. Stats. Ann. § 2852-609; P.L. 364, Art. VI, § 609 (1933):

§ 609. *Liability of Subscribers and Shareholders*

A subscriber to, or holder of, shares of a corporation formed under this act shall not be under any liability to the corporation with respect to such shares, other than the obligation of complying with the terms of the subscription for such shares. Any person becoming an assignee or transferee of shares, or of a subscription for shares, in good faith and without knowledge or notice that the full consideration therefor has not been paid, shall not be personally liable to the corporation or its creditors for any unpaid portion of such consideration. No person holding shares as executor, administrator, guardian, trustee, receiver, or in any other representative or fiduciary capacity, shall be personally liable as a shareholder by reason of so holding such shares, but the estate and funds in the hands of such fiduciary or representative shall be so liable. No pledgee or

other holder of shares as collateral security shall be personally liable as a shareholder, but the person pledging such shares shall be considered the holder thereof and shall be liable as a shareholder.

Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P.L. 364, Art. VI, § 610 (1933):

§ 610. *Validity of Shares*

The fact that shares are issued in violation of, or without full compliance with, the provisions of this act shall not make the shares so issued invalid, unless they are issued in violation of Article XVI, Section seven, of the Constitution of this Commonwealth.

Pa. Bus. Corp. L. § 701: 15 Purdon's Pa. Stats. Ann. § 2852-701; P.L. 364, Art. VII, § 701 (1933), *amended* P.L. 1123, § 1 (1935), *amended* P.L. 711, § 1 (1957):

§ 701. [*Directors may declare dividends*

A. [Subject to the restrictions contained in the articles of the corporation and the provisions of this article, any business corporation, by its board of directors, may declare and pay dividends upon the outstanding shares of the corporation out of its surplus, as hereinafter provided, from time to time and to such extent as the board of directors may deem advisable. Dividends may be paid in cash, in property, or in shares of the corporation, but no corporation shall pay dividends:

[(1) In cash or property, except from the surplus of the aggregate of its assets over the aggregate of its liabilities, including in the latter the amount of its stated capital, after deducting from such aggregate of its assets the amount by which such aggregate was increased by unrealized appreciation in value or revaluation of fixed assets, unless the amount

thereof shall have been transferred to, or included in, its stated capital.

[(2) • • •

B. [In computing the aggregate of the assets of the corporation, the board of directors shall determine and make proper allowance for depreciation and depletion sustained, and losses of every character, except as otherwise provided in this section. Deferred assets and prepaid expenses shall be written off at least annually in proportion to their use, as may be determined by the board of directors. Amounts of surplus arising from an unrealized appreciation or revaluation of fixed assets shall be shown on the books of the corporation as a separate item apart from surplus profits or paid-in surplus.]

C. • • •

[*Foregoing repealed in 1957; see new § 704.*]

Pa. Bus. Corp. L. § 704B; 15 Purdon's Pa. Stats. Ann. § 2852-704B; P.L. 364, Art. VII, § 704 (1933), *amended* P.L. 331, § 1 (1951), P.L. 711, § 1 (1957):

§ 704. *Special provisions relating to surplus and reserves*

A. • • •

B. The portion, if any, of the capital surplus of a business corporation arising from revaluation of or unrealized appreciation in assets may be decreased, from time to time, by resolution of the board of directors, directing such decrease and an equal decrease in the book value of such assets. Upon the realization of any such increase in value, the board of directors may, by resolution, transfer from capital surplus to earned surplus the amount realized.

• • •

[*Entire § 704B newly enacted in 1957; see former § 701A, B.*]

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N. Y. Pers. Prop. L. (40 McKinney's N. Y. Consol. L.) § 33; L. 1934, c. 142; *subd. 3 added by* L. 1941, c. 331, § 3, *amended by* L. 1943, c. 5, L. 1944, c. 588, § 5; *subd. 4 added by* L. 1941, c. 330, § 3, *amended by* L. 1944, c. 588, § 5.

§ 33. *Validity of certain agreements made without consideration*

1. An agreement for the purchase, sale, transfer or delivery of a certificate or other evidence of debt, issued by the United States or by any state, or a municipal or other corporation, or of any share or interest in the stock of any bank corporation or joint stock association, incorporated or organized under the laws of the United States or of any state, is not void or voidable, for want of consideration, or because of the non-payment of consideration, or because the vendor, at the time of making such contract, is not the owner or possessor of the certificate or certificates or other evidence of debt, share or interest.

* * *

3. A promise hereafter made in writing and signed by the promisor or by his agent shall not be denied effect as a valid contractual obligation on the ground that consideration for the promise is past or executed, if the consideration is expressed in the writing and is proved to have been given or performed and would be a valid consideration but for the time when it was given or performed.

4. An assignment hereafter made shall not be denied the effect of irrevocably transferring the assignor's rights because of the absence of consideration, if such assignment is in writing and signed by the assignor, or by his agent.

* * *

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N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 86; 69 Purdon's Pa. Stats. Ann. § 61, P.L. 543, § 5 (1915) [*Repealed*]; Uniform Sales Act, § 5:

§ 86. *Existing and future goods*

1. The goods which form the subject of a contract to sell may be either existing goods, owned or possessed by the seller, or goods to be manufactured or acquired by the seller after the making of the contract to sell, in this article called "future goods."

2. There may be a contract to sell goods, the acquisition of which by the seller depends upon a contingency which may or may not happen.

3. Where the parties purport to effect a present sale of future goods, the agreement operates as a contract to sell the goods.

N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 87; 69 Purdon's Pa. Stats. Ann. § 62, P.L. 543, § 6 (1915) [*Repealed*]; Uniform Sales Act, § 6:

§ 87. *Undivided shares*

1. There may be a contract to sell or a sale of an undivided share of goods. If the parties intend to effect a present sale, the buyer, by force of the agreement, becomes an owner in common with the owner or owners of the remaining shares.

2. In the case of fungible goods, there may be a sale of an undivided share of a specific mass, though the seller purports to sell and the buyer to buy a definite number, weight or measure of the goods in the mass is undetermined. By such a sale the buyer becomes owner in common of such

a share of the mass as the number, weight or measure bought bears to the number, weight or measure of the mass. If the mass contains less than the number, weight or measure bought, the buyer becomes the owner of the whole mass and the seller is bound to make good the deficiency from similar goods unless a contrary intent appears.

N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 98; 69 Purdon's Pa. Stats. Ann. § 141, P.L. 543, § 17 (1915) [*Repealed*]; Uniform Sales Act, § 17:

§ 98. *No property passes until goods are ascertained*

Where there is a contract to sell unascertained goods no property in the goods is transferred to the buyer unless and until the goods are ascertained, but property in an undivided share of ascertained goods may be transferred as provided in section eighty-seven [P. S. § 62; U. S. A. § 6].

N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 99; 69 Purdon's Pa. Stats. Ann. § 142, P.L. 543, § 18 (1915) [*Repealed*]; Uniform Sales Act, § 18:

§ 99. *Property in specific goods passes when parties so intend*

1. Where there is a contract to sell specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.

2. For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties, usages of trade and the circumstances of the case.

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N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 100; 69 Purdon's Pa. Stats. Ann. § 143, P.L. 543, § 19 (1915) [*Repealed*]; Uniform Sales Act, § 19:

§ 100. *Rules for ascertaining intention*

Unless a different intention appears, the following are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer.

* * *

Rule 2. Where there is a contract to sell specific goods and the seller is bound to do something to the goods, for the purpose of putting them into a deliverable state, the property does not pass until such thing be done.

* * *

Rule 4. 1. Where there is a contract to sell unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer, or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

* * *

N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 156(1); 69 Purdon's Pa. Stats. Ann. § 337(1), P.L. 543, § 76(1) (1915) [*Repealed*]; Uniform Sales Act, § 76(1):

§ 156. *Definitions*

1. In this article, unless the context or subject-matter otherwise requires:

* * *

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"Fungible goods" means goods of which any unit is from its nature or by mercantile usage treated as the equivalent of any other unit.

* * *

"Value" is any consideration sufficient to support a simple contract. An antecedent or pre-existing claim, whether for money or not, constitutes value where goods or documents of title are taken either in satisfaction thereof or as security therefor.

* * * *

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 162; 15 Purdon's Pa. Stats. Ann. § 301, P.L. 126, § 1 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 1:

§ 162. *How title to certificates and shares may be transferred.*

Title to a certificate and to the shares represented thereby can be transferred only,

(a) By delivery of the certificate indorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby, or

(b) By delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign or transfer the same or the shares represented thereby, signed by the person appearing by the certificate to be the owner of the shares represented thereby. Such assignment or power of attorney may be either in blank or to a specified person.

(c) *By delivery of a separate instrument containing a written assignment of the certificate, or an interest therein, executed by the officer who levies an execution against property upon such certificate, or such interest therein, and sells*

the same, to the purchaser on the execution sale, and such assignment shall, together with delivery of the certificate, effect a transfer of the title to the certificate, or the interest therein levied upon and sold as specified in such assignment, and the shares represented by such certificate, or such interest therein, to the purchaser at the execution sale.

The provisions of this section shall be applicable although the charter or articles of incorporation or code of regulations or by laws of the corporation issuing the certificate and the certificate itself provide that the shares represented thereby shall be transferable only on the books of the corporation or shall be registered by a registrar or transferred by a transfer agent.

[*Italicized words added to New York statute only*, L. 1936, c. 153, § 2.]

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 164; 15 Purdon's Pa. Stats. Ann. § 303, P.L. 126, § 3 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 3:

§ 164. *Corporation not forbidden to treat registered holder as owner*

Nothing in this article or in article 6-A shall be construed as forbidding a corporation,

(a) To recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, or

(b) To hold liable for calls and assessments a person registered on its books as the owner of shares.

[*Italicized words added to New York statute only*, L. 1962, c. 839, § 1.]

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N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 165; 15 Purdon's Pa. Stats. Ann. § 304, P.L. 126, § 4 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 4:

§ 165. *Title derived from certificate extinguishes title derived from a separate document*

The title of a transferee of a certificate under a power of attorney or assignment not written upon the certificate, and the title of any person claiming under such transferee, shall cease and determine if, at any time prior to the surrender of the certificate to the corporation issuing it, another person, for value in good faith, and without notice of the prior transfer, shall purchase and obtain delivery of such certificate with the indorsement of the person appearing by the certificate to be the owner thereof, or shall purchase and obtain delivery of such certificate and the written assignment or power of attorney of such person, though contained in a separate document.

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 171; 15 Purdon's Pa. Stats. Ann. § 310, P.L. 126, § 10 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 10:

§ 315. *Lien of corporation and restrictions on transfer*

There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation, and there shall be no restriction upon the transfer of shares so represented, by virtue of any by-law of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate.

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N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 176; 15 Purdon's Pa. Stats. Ann. § 315, P.L. 126, § 15 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 15:

§ 176. *There shall be no lien or restriction unless indicated on certificates*

There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation and there shall be no restriction upon the transfer of shares so represented by virtue of any by-law of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate.

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 179; 15 Purdon's Pa. Stats. Ann. § 318, P.L. 126, § 18 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 18:

§ 179. *Rule for cases not provided for by this article*

In any case not provided for by this article, the rules of law and equity, including the law merchant, and in particular the rules relating to the law of principal and agent, executors, administrators and trustees, and to the effect of fraud, misrepresentation, duress or coercion, mistake, bankruptcy or other invalidating cause, shall govern.

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 183; 15 Purdon's Pa. Stats. Ann. § 322, P.L. 126, § 22 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 22:

§ 183. *Other definitions*

1. In this article, unless the context or subject-matter otherwise requires—

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"Certificate' means a certificate of stock in a corporation organized under the laws of this state or of another state whose laws are consistent with this article.

"Delivery" means voluntary transfer of possession from one person to another.

"Person" includes a corporation or partnership or two or more persons having a joint or common interest.

To "purchase" includes to take as mortgagee or as pledgee.

"Purchaser" includes mortgagee and pledgee.

"Shares" means a share or share of stock in a corporation organized under the laws of this state or of another state whose laws are consisted with this article.

"State" includes state, territory, district and insular possession of the United States.

"Transfer" means transfer of legal title.

"Title" means legal title and does not include a merely equitable or beneficial ownership or interest.

"Value" is any consideration sufficient to support a simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a certificate is taken either in satisfaction thereof or as security therefor.

2. A thing is done "in good faith" within the meaning of this article, when it is in fact done honestly, whether it be done negligently or not.

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 1-105; P.L. 3, § 1-105 (1953), *amended P.L.* 1023, § 1 (1959):

§ 1-105. ***Territorial Application of the Act; Parties' Power to Choose Applicable Law***

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also

to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

* * *

Applicability of the Article on Investment Securities. Section 8-106.

* * *

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 2-105; P.L. 3, § 2-105 (1953):

§ 2-105. *Definitions: Transferability; "Goods"; "Future" Goods; "Lot"; "Commercial Unit"*

(1) * * *

(2) Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

* * *

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12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-103; P.L. 3, § 8-103 (1953):

§ 8-103. *Issuer's Lien*

A lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such lien is set forth conspicuously on the security.

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-104; P.L. 3, § 8-104 (1953), *amended* P.L. 1023, § 8 (1959):

§ 8-104. *Effect of Overissue; "Overissue"*

(1) The provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, [or] issue [results] *or reissue would result in overissue;* but

(a) if an identical security which does not constitute an overissue is *reasonably* available for purchase [on the market], the person entitled to issue or validation may compel the issuer to purchase and deliver such a security to him against surrender of the security [which constitutes the overissue and], *if any, which he holds; or*

(b) if a security is not so available for purchase, [the purchaser] *the person entitled to issue or validation* may recover from the issuer the price he *or the last purchaser for value* paid for it *with interest from the date of his demand.*

(2) "Overissue" means the issue in excess of the amount which the issuer has corporate power to issue.

[*Italicized words added, and bracketed words deleted, by 1959 amendment.*]

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12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-106; P.L. 1023, § 8 (1959):

§ 8-106. *Applicability*

The validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law (including the conflict of laws rules) of the jurisdiction of organization of the issuer.

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-204; P.L. 3, § 8-204 (1953):

§ 8-204. *Effect of Issuer's Restrictions on Transfer*

A restriction on transfer imposed by the issuer even though otherwise lawful is ineffective unless noted conspicuously on the security.

21 Purdon's Pa. Stats. Ann. § 601, P.L. 425, § 1 (1901):

§ 601. [*RESULTING TRUSTS*] *Validity*

Whenever hereafter a resulting trust shall arise with respect to real property, by reason of the payment of the purchase money by one person, and the taking or making of a legal title in the name of another, if the person advancing the purchase money has the capacity to contract, such resulting trusts shall be void and of none effect as to bona fide judgment or other creditors, or mortgagees of the holder of the legal title, or purchasers from such holder without notice unless either (1) a declaration of trust in writing has been executed and acknowledged by the holder of the legal title, and recorded in the recorder's office of the county where the land is situated, or (2) unless an action of ejectment has been begun, in the proper county, by the person advancing the money, against the holder of the legal title.

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N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) § 91:

§ 91. *Certain uses and trusts abolished*

Uses and trusts concerning real property, except as authorized and modified by this article, have been abolished; every estate or interest in real property is deemed a legal right, cognizable as such in the courts, except as otherwise prescribed in this chapter.

N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) § 94:

§ 94. *Grant to one where consideration paid by another*

A grant of real property for a valuable consideration, to one person, the consideration being paid by another, is presumed fraudulent as against the creditors, at that time, of the person paying the consideration, and, unless a fraudulent intent is disproved, a trust results in favor of such creditors, to an extent necessary to satisfy their just demands; but the title vests in the grantee, and no use or trust results from the payment to the person paying the consideration, or in his favor, unless the grantee either,

1. Takes the same as an absolute conveyance, in his own name, without the consent or knowledge of the person paying the consideration; or,

2. In violation of some trust, purchases the property so conveyed with money or property belonging to another.

SUPREME COURT, U. S.
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Supreme Court of the United States

OCTOBER TERM, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

IN THE MATTER

of

NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC.,

Debtor

In Proceedings for the Reorganization of a Corporation, Two Cases (No. 26362 and No. 27000)

BRIEF FOR RESPONDENT JEROME FRIED ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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The Supreme Court has granted certiorari to the Court of Appeals for the Second Circuit in two cases, one numbered 26,362 in that Court and the other 27,000. These cases are entirely separate, presenting no common issue of law or fact. They are related only in that they arise in the same corporate reorganization proceeding in the Bankruptcy Court. Accordingly, they are briefed separately herein.

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Supreme Court of the United States

OCTOBER TERM, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

IN THE MATTER

of

NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC.,

Debtor.

BRIEF FOR RESPONDENT JEROME FRIED ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

CASE ONE

(No. 26362)

Statutes Involved.

Sections 189 and 191 in Article VIII, and all of Article XIII (§§241-250) of the Bankruptcy Act are set forth in the appendix.

Question Presented.

Does §249 of the Bankruptcy Act, which requires applicants for compensation or reimbursement of expenses to file a statement under oath as to trading in the corporation's stock, and denies compensation or reimbursement to applicants who have bought or sold the Debtor's stock during the pendency of the proceeding, apply to one who is employed by the Debtor-in-Possession in a managerial capacity on a weekly salary and is not an applicant for compensation or reimbursement under Article XIII?

Statement of the Case.*

Jerome Fried was manager of Nazareth Fairgrounds & Farmers' Market, Inc. before the institution of the Chapter X Proceeding [R 45]. When the proceeding was commenced, his employment was continued by court order under the mistaken impression that he was secretary and treasurer of the corporation [R 17]*. Subsequent orders increased his weekly salary as "manager" from $50 to $150 [R 21-2] and to $200 [R 38-9].

Fried's duties consisted of: the collection of rents from the several tenants of the market; the arrangement of joint advertisement of the tenants' wares; preliminary negotiations for the renting of space in the market; general superintendence, seeing that the premises were kept in a clean and proper condition. He signed no leases, contracts or documents binding the Debtor; signed no checks. All matters of importance, including the making of the leases, were referred to Weinstein, the president [R 485-9].

---

* For an employee, as Fried was, such an order was unnecessary. *In re Wil-Low Cafeterias* (2 C. A. 1940) 111 F. 2d 429, 431.

The Court of Appeals found:

> "The administration has been successful, gross business having tripled from 1953 to 1959 and profits having arisen from zero to $41,269." [R 575].

Fried has made no application for allowance and has never signed any petition or affidavit in connection either with his original employment and salary, or with any subsequent employment or increase in salary.

The District Court discharged Fried and terminated his compensation "solely because [he] had violated §249 of the Bankruptcy Act by trading in the Debtor's stock and upon no other basis" [R 249]. The Court of Appeals made it clear that neither it nor the Court below was dealing "with breaches of fiduciary obligation"; that the Court below had not exercised discretion:

> "The distinction is that such a ruling would rest upon an exercise of judicial discretion, taking appropriate account of all relevant circumstances, rather than on the automatic forfeiture which the judge here thought the statute required." [R 581].

Pertinent Statute.

"Sec. 249. Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock,

or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred."

Summary of Argument.

The provision of §249, which bars from allowances in corporate reorganization proceedings applicants who have traded in the corporation's stock during the course of the proceeding, does not extend beyond the boundaries of Article XIII. The compensation not to be "allowed" to applicants under that section is the same "allowance" for which a hearing and notice to all persons in interest is required by §247.

A salaried employee who is hired as incidental to the operation of the business and management of the property of the Debtor under §189, is not a person acting in a "fiduciary capacity" under §249. §249 denies compensation because of stock trading "to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity". The word "fiduciary", which is a word of uncertain content, readily takes its meaning from its associates. Thus, while the section has often been applied to committee representatives and to attorneys, it has never been applied to a salaried employee. It is the persons who are brought in for the reorganization and who will have a voice in the plan finally to emerge that §249 applies, and not to salaried employees, no matter how important their ministerial functions are to the corporation.

The distinction is between applicants for the Court's grace whose compensation is dependent upon whether they benefited the estate on the one hand, and servants whose compensation is dependent upon the contract of employment on the other.

The application of §249 to employees, even those of managerial rank (especially if the corporation is a large one), is wholly impracticable. The filing in court of a statement under oath showing no trading in the stock under §249, and notice and hearing, which §247 requires, could not possibly fit in with the orderly conduct of the Debtor's business. Moreover, strict construction is called for in the case of a penal statute, which experience has shown to be unduly harsh, and which is in derogation of the common law.

The contention that the Court in its discretion should discharge Fried for misconduct raises a feigned issue. The question of misconduct was litigated in a parallel controversy, now finally decided adversely to petitioners.* Review of that question was not sought of this Court, and time to do so has long since expired.

POINT I.

Section 249 may not be construed to cover a salaried employee.

A. The job of manager-employee is not included in the description of persons subject to §249.

(1) Certainly the statute does not say "employee", "manager", "agent" or even "officer". The persons covered are described as a "committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity"**. The only word upon which an argument can be based to include Fried is "fiduciary". But

* *Wolf* v. *Nazareth Enterprises, Inc. et al* (2 C. A. May 4, 1962) 303 Fed. 2d 152.

** When petitioners quote the statute (Brief, 4, 133), they omit the words "committee or attorney, or other", obviously to avoid *noscitur a sociis* and thereby stretch the statute.

"fiduciary" is a chameleon, which easily takes its color from its background.

To quote Mr. Justice Frankfurter in *SEC* v. *Chenery Corp.* (1943) 318 U. S. 80, 85-6:

> "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

Here, Fried was a fiduciary only in the loose, general sense that every agent is such. The "fiduciary" mentioned in the statute is manifestly of the type that goes with the other appellations used.

Fried was not a "committee or attorney". He represented no one. Whether he was in a "fiduciary capacity" within the meaning of §249 manifestly depends, not on whether he held a position of dignity and importance in the operation of the business, but on whether he acted in a fiduciary capacity "in the proceedings", which must mean in matters directly affecting the plan of reorganization.

With respect to §243, a neighbor of §249 in Article XIII, it was said, per Hamilton, C. J., in *Gochenour* v. *Cleveland Terminals Bldg. Co.* (6 C. A. 1944) 142 F. 2d 991, 995, cert. den. 323 U. S. 767:

> "This section of the Act relates entirely to matters in connection with the reorganization of the debtor and proceedings on behalf of creditors and stockholders. It comprehends matters directly affecting the plan of reorganization and excludes those indirectly affecting it."

Fried had nothing whatever to do with the reorganization, and was in no position to formulate a plan or to participate in its formulation.

(2) Nor is Fried properly described as an "insider". While, as the collector of rents and manager of the property he would, no doubt, have information as to the receipts and disbursements of the Debtor with respect to the property, this is the same information which anyone could have by inspecting the monthly statements filed under the order of the Court [R 17-18].

(3) There is nothing to indicate that §249 was meant to apply to the day-to-day activities of an employee of the Debtor-in-Possession. In practically every case where a Debtor is continued as Debtor-in-Possession the business, of necessity, is operated by employees and officers who are continued on a salaried basis. Yet no reported case has come to hand in which any court has applied §249 to such employees or officers, or, indeed, to any other than committeemen or other representatives of security holders, or to the attorneys for them or for the Debtor. In the lone case in which it was sought to apply the statute to a trust company that had acted as a depositary for assents to the plan of reorganization, the Court refused to apply the bar upon the ground that the depositary's duties were administrative in nature. *In re Brown Co.* (D. Me. 1941) 36 F. Supp. 275, 277. *A fortiori* §249 cannot be applied to a working manager who has nothing to do with the reorganization process. It is manifest that §249 was intended to apply only to those persons who in a fiduciary capacity could influence the plan of reorganization finally to emerge.

B. The location of §249 in Article XIII of the Act indicates its limitation to applicants for allowances in the reorganization proceeding.

(1) The Debtor-in-Possession was empowered to continue Fried's employment under the authorization to operate the business and manage the property under §189

of the Bankruptcy Act. While the Debtor-in-Possession went through the form of obtaining the approval of the Court, as in the case of an officer under §191, this was not necessary. *In re Wil-Low Cafeterias* (2 C. A. 1940) 111 F. 2d 429, 431; *In re Avorn Dress Co., Inc.* (2 C. A. 1935) 78 F. 2d 681, 683.

Fried did not apply for the original order of employment or for the subsequent orders increasing his compensation. Fried is not now, and never has been an applicant for compensation from the Court.

(2) §249 is found in Article XIII of the Bankruptcy Act, entitled "Compensation and Allowances". Article XIII is a complete whole, dealing with the applications for, and the granting of allowances to those functionaries who must look to the Court for an allowance intermediate their service, or at its end. With the possible exception of the indenture trustee, all of the persons mentioned in the article belong to the group who are strangers to the Debtor until the proceedings are initiated, and who will have nothing to do with the Debtor after the plan has been confirmed. There is the referee, special master, trustee, other court officers, the attorneys for any of them, the attorney for the Debtor or for the petitioning creditors, the depositaries, reorganization managers, committees or representatives of creditors or stockholders, and their agents and attorneys. True, there is provision for "other parties in interest except the Securities and Exchange Commission", but the functions of the persons who are specified are such as to indicate that the entire article relates to the reorganization crew and not to the continuing employees of the Debtor.

§249 fits like a glove the sections which precede it in Article XIII. By §249 no compensation or reimbursement

shall be "allowed" if the applicant has traded in stock. The word "allowed" appears in §248, and the word "allow" in each of §§241, 242, 243, 244, 245 and 246. §§247, 248 and 250 speak of "allowances". "Allowed" and "allow" are verbal forms, and "allowances" is the noun. Manifestly, the applications dealt with under §249 are for the same "allowances" for which notice and a hearing are required under §247. On the other hand, it was a salary that was being paid to Fried [R 24, 29, 39]. Nowhere in Article XIII is there any mention of "salary".*

According to Black's Law Dictionary (p. 97):

> "*Allowance.*
>
> * * * * * *
>
> "As distingished from a 'salary,' which is a fixed compensation, decreed by authority and for permanence, and is paid at stated intervals, and depends upon time, and not the amount of the services rendered, 'allowance' is a variable quantity."

This Court has said in *Benedict* v. *United States* (1900) 176 U. S. 357, 360:

> "The word 'salary' may be defined generally as a fixed annual or periodical payment for services, depending upon the time and not upon the amount of services rendered."

(3) Petitioners argue [Brief 153] that Article XIII is not self-contained. They say that reference must be had to §221(4) which provides that the judge may confirm a plan if satisfied that payments made or promised for services in connection with the proceeding are "reasonable". This Court, they say, has said that "reasonable" in that section

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* For the distinction between salary and allowance see *Mangam* v. *The City of Brooklyn* (1885) 98 N. Y. 585, 598.

"necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act."* But Article XIII in each of §§241, 242, 243, 244 and 245 provides that the compensation must be "reasonable". There is no reason why this use of "reasonable" should not also imply loyal and disinterested service. Furthermore, §221(4) relates, not to allowances by the Court, but to payments or promises made by others, and not originating with the Court. Thus, the case petitioners cite** is one in which attorneys were endeavoring to enforce a promise for compensation made to them by the committee of security holders that they represented. It could not have been the Congressional intent that the judge, having fixed an allowance as reasonable under Article XIII before confirmation of the plan, should turn his cap about and, in an appellate capacity, now determine that the compensation he had previously fixed, and which may already have been paid, was reasonable or unreasonable. In other words, there is no reason to go outside of Article XIII upon any question relating to the applications of the various reorganizers for compensation. Yet petitioners have ripped this §249 from its setting in Article XIII and are attempting to apply it to the employment of personnel by the Debtor or Debtor-in-Possession to which it obviously bears no relation.

(4) Petitioners argue [Brief 152] that the location of §249 in Article XIII should be disregarded for purposes of construction because of an appended provision in the Act of June 22, 1938, which put the Bankruptcy (Chandler) Act into effect. It reads:

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* *Woods* v. *City Bank Co.* (1941) 312 U. S. 262, 268.

** *Leiman* v. *Guttman* (1949) 336 U. S. 1.

> "b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate."

This has no bearing. Respondent does not rely upon any section or subdivision heading, but upon the entire scheme and plan of the Bankruptcy Act, and particularly upon the pattern of Article XIII.

C. The contractual relation of employees to the Debtor sets them off from applicants to the Court for an allowance.

(1) Employees of the Debtor or Debtor-in-Possession stand in an entirely different position to the Debtor from the persons covered by §249. In one case, the relationship is contractual; in the other, there is no contract, and compensation depends on benefit to the estate as determined in the Court's discretion. No doubt the Debtor's payroll is subject to the Court's direction, and the Court could step in at any time and increase or decrease the salary of any employee for the future. By the same token the employee, if dissatisfied, could resign and seek employment elsewhere.

Applicants for an allowance stand on an entirely different footing. They have no contractual claim against the Debtor. Their application is based on benefit to the estate.

By §243:

> "In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto."

Applicants for an allowance stand before the Court seeking its grace, and the Court, subject to appellate review, may in its discretion grant or refuse an allowance. In *Dick-*

inson Co. v. *Cowan* (1940) 309 U. S. 382, the Court said, per Douglas, J. (p. 389):

> "Fee claimants are either officers of the court or fiduciaries, such as members of committees, whose claims for allowance from the estate are based only on service rendered to and benefits received by the estate. Allowance or disallowance involves an exercise of sound discretion by the court based on that statutory standard."

An employee might turn in an indifferent performance and yet be entitled to his salary. As for an applicant for allowance, however, "Whether an application for an allowance be considered under section 242 or 243, administrative services must benefit the estate, if compensation is to be allowed." Swan, C. J. *In re Postal Telegraph & Cable Corporation* (2 C. A. 1941) 119 F. 2d 861, 862.

Petitioners picture Fried as an applicant for an allowance who is privileged to receive his compensation weekly instead of having to wait until the conclusion of the case. This wholly ignores the distinction between those working on contract on the one hand, and those working in anticipation of an allowance on the other. It would be a quaint conception that all employees of a Debtor-in-Possession are merely applicants for allowance under §249, and that the weekly stipends that they receive are to be regarded merely as tentative advances subject to refund.

(2) Petitioners seek to break down this obvious distinction. They assert [Brief 156] "Except the trustee, the additional trustee, the trustee's attorney, and the examiner, virtually every other person serving in the proceedings, and looking to the estate for compensation, is appointed and compensated by 'consensual arrangements' with his respec-

tive clients". The exception comes near swallowing the proposition asserted. However, while the appointment (as that of attorneys, for example) may be initiated by consensual arrangement, the compensation is never a matter of "consensual arrangement". In *Leiman* v. *Guttman* (1949) 336 U. S. 1, which petitioners cite, it was expressly held that the attorneys for a securities' committee were not entitled to shares that had been set aside as their compensation by agreement with the committee, but must look to the District Court for an allowance.

D. The procedural requirements for an allowance do not permit the extension of Section 249 to salaried employees.

(1) If §249 is to be applied to an employee of a Debtor-in-Possession, must it not also be applied to an employee of a Debtor not in possession, since his compensation also comes out of the estate? If it is to be applied to an employee of managerial rank, how far down the scale does the section reach? Assuming one of our large corporations with hundreds of managerial employees in its various branches and factories was being reorganized under Chapter X, would it apply to all of these?

The section requires that an applicant for an allowance "shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding". Must all employees, before receiving each weekly salary check, file such a statement under oath, and not with the employer, but with the court?

(2) Petitioners [Brief, 153-4] would solve this dilemma by having the employee file such a statement before he

received any salary at all; "additional statements need be filed only when new circumstances require new disclosures". Such a system would work if the employee were to be compensated only if he had traded in the stock. But, since a negative is required before compensation can be allowed, it is difficult to see how, under the command of the statute, the weekly statement could be dispensed with.

Petitioners go so far (Brief, 153) as to suggest that the second part of the section is the important part, and that the first part, requiring the statement under oath, can be disregarded. The fact, however, that the statute does require the filing of such a statement before an allowance can be granted, argues strongly that Congress in this section was dealing only with the usual application for an allowance and the papers in its support.

(3) Petitioners construe the statute, not only as requiring the discharge of the employee and the withholding from him of any pay, future or in arrears, but also the restitution by him of all wages previously paid him. The very extremes to which petitioners' logic carries their interpretation of the statute is persuasive that their construction is not a sensible one. Such an interpretation would so amend the statute that its own draftsman could not recognize it. It would mean that every employee who, or whose wife,* has purchased a share of stock at any time during the course of the reorganization would be subject to automatic discharge and forfeiture of all wages previously earned and paid.

(4) Finally §249 cannot apply to the salary of an employee unless it is compensation "allowed" under the

* Cf. *In re Midland United Co.* (3 C. A. 1947) 159 F. 2d 340; *Berner v. Equitable Office Bldg. Corp.* (2 C. A. 1949) 175 F. 2d 218.

language of that section. But by §247 the judge must fix "a time of hearing for the consideration of applications for allowances" and notice must be given to creditors, stockholders, the Securities and Exchange Commission and other persons designated by that section. Thus, if §249 is to be applied to a salaried employee, such hearing and notice must precede the weekly paycheck. In the case of Fried, 485 such hearings would have been required.

POINT III.

Since it is a penal statute in derogation of the common law and unduly harsh in its operation, Section 249 should be strictly construed.

A. Section 249 alters pre-existing law.

This Court has, in effect, so held. In *SEC* v. *Chenery Corporation* (1943) 318 U. S. 80, a proceeding for the reorganization of a registered holding company under the Public Utility Holding Company Act of 1935, respondents, who were officers, directors and controlling stockholders, had purchased preferred stock of the corporation during the proceeding. The Commission had disapproved a plan of reorganization which would have permitted respondents to exchange the stock thus acquired for stock of the reorganized corporation on the same basis as other preferred stockholders, and had recommended a formula under which the stock so acquired by respondents should be surrendered for cost plus 4%. Such a plan was then proposed and approved by the Commission. The Court of Appeals set aside the Commission's order, and this Court remanded the case for further consideration pointing out that "there were no principles of law or equity which in themselves would be

sufficient to justify this order [of the Commission]"*. The Court said, per Mr. Justice Frankfurter (p. 88):

> "If, therefore, the rule applied by the Commission is to be judged solely on the basis of its adherence to principles of equity derived from judicial decisions, its order plainly cannot stand. As the Commission concedes here, the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock."

And again (p. 93):

> "Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions."

To the same effect is *Manufacturers Trust Co.* v. *Becker* (1949) 338 U. S. 304.

Here is a statute, §249, which penalizes stock purchases by specified persons during the pendency of the Chapter X reorganization proceeding. Since this is a departure from "established judicial doctrines", the section is subject to strict construction. *Herd & Co.* v. *Krawill Machinery Corp.* (1959) 359 U. S. 297, 304-5; *Shaw* v. *Railroad Company* (1879) 101 U. S. 557, 565.

B. Section 249 is a penal statute.

(1) Certainly a statute imposes a penalty when the forfeiture exacted bears no relation to the damage sustained, and may even be incurred where there is no damage. *Hunt-*

* The quotation is from this Court's explanation of this decision in a subsequent decision (1947) 332 U. S. 194, 198, when the case was again before it.

ington v. *Attrill* (1892) 146 U. S. 657, 667, defines "penal" and "penalty" as "including any extraordinary liability to which the law subjects a wfongdoer in favor of the person wronged, not limited to the damages suffered". Thus, *Bolles* v. *Outing Co.* (1899) 175 U. S. 262, 264, in holding penal and, therefore, subject to strict construction, R. S. 4965, the forfeiture section under the Copyright Law, said (p. 264):

> "It makes no pretense of awarding damages, and simply imposes a forfeiture of a specified sum".

Under §249, the purchase of a single share during the proceeding may deprive the purchaser of compensation and out-of-pocket expenses amounting to thousands of dollars.

For the proposition that the statute is penal there is high authority.

Commissioner Douglas of the SEC thus testified before the House Committee on Judiciary on H. R. 6439, subsequently amended and reintroduced as H. R. 8046, 75th Congress, 1st Session (p. 183):

> "The Chandler bill makes further significant changes in that respect. On page 65 there is a very important provision, that those who have purchased or sold securities in contemplation of or after the commencement of the proceedings should not be allowed compensation or reimbursement from the estate. Now, this is a development of the idea that fiduciaries who trade in securities should be *penalized;* that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law. Committees for example, have included in deposit agreements contract provisions designed to alter these common-law rules governing fiduciaries. And they have pretty well succeeded in doing so." [Emphasis added]

In *Silbiger* v. *Prudence Bonds Corporation* (2 C. A. 1950) 180 F. 2d 917, cert. den. 340 U. S. 813, Judge Learned Hand, in holding that the strictures of §249 did not apply to an attorney whose client had traded in the corporation's securities, four times characterized the forfeiture provision of §249 as a "penalty".

(2) Petitioners argue [Brief 148] that §249 is not penal, but remedial. For this they cite only *Adler* v. *Klawans* (2 C. A. 1959) 267 F. 2d 840, which deals with an entirely different statute, §16(b) of the Securities Exchange Act. There is conflict whether the provisions of that statute are remedial or punitive*. If §249 had provided for a recovery of the profits made upon the stock traded, either at the suit of the corporation or of a stockholder, the case cited might have application. Under §16(b) there is restitution to the other stockholders of profits from the forbidden transaction by their addition, when recovered, to the corporation's assets. But under §249 there is no element of restitution. For having dealt in the stock, the culprit is penalized, not to the extent of his profits, but in the entirely different field of reimbursement for expenses and compensation for services to the reorganization. Elsewhere petitioners say, perhaps unguardedly [Brief 151], that §249 has "the Congressional and judicial purpose of preventing and *penalizing* insider trading". This makes it unanimous.

To apply §249 to the salaried employee of a Debtor or Debtor-in-Possession "would do violence to the well estab-

* *See Commissioner* v. *Obear-Nester Glass Co.* (7 C. A. 1954) 217 F. 2d 56, cert. den. 348 U. S. 982, rehearing den. 349 U. S. 948; *General American Investors Co., Inc.* v. *Commissioner* (2 C. A. 1954) 211 F. 2d 522; aff'd 348 U. S. 434; *Smolowe* v. *Delendo Corporation* (2 C. A. 1943) 136 F. 2d 231, cert. den. 320 U. S. 751; and *Park & Tilford Distillers Corp.* v. *United States* (Ct. Cl. 1952) 107 F. Supp. 941, cert. den. 345 U. S. 917.

lished principle that penal statutes are to be construed strictly"*.

C. Section 249 works an excessively harsh result.

The Court below in this case characterized §249 as inflicting a "Draconian penalty". Judge Learned Hand called it "drastic"[1]. So did Judge Hincks, and he also called the case one of "hardship"[2]. Judge Dimock found the imposition of §249 "tragic"[3], and on appeal the Court noted that the result worked "harshly"[4]. The District Court below in this case considered Judge Dimock's use of the word "tragic" apt [R 480].

Frequently, when §249 has been applied, the Court has been so moved by the injustice of the result as to feel called upon to apologize for the decision.

In this case the District Court imposed the penalty with "regret" [R 492].

In *In re Central States Electric Corp.* (D. C. Va. 1953) 112 F. Supp. 281, appeal den. 206 F. 2d 70, cert. den. 346 U. S. 899, the Court applied §249 "with reluctance" (p. 288).

Where §249 does apply, and allowance must be denied, the Court does not regard even offending members of stockholder committees as utterly depraved. In *Finn* v. *Childs Co.* (2 C. A. 1950) 181 F. 2d 431, the Court said, per Clark, C. J. (p. 441):

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* *F. C. C.* v. *American Broadcasting Co., Inc.* (1954) 347 U. S. 284, 296.

[1] *Berner* v. *Equitable Office Bldg. Corporation* (2 C. A. 1949) 175 F. 2d 218, 222.

[2] *In re Norwalk Tire & Rubber Co.* (D. C., Ct. 1951) 96 F. Supp. 274, 276.

[3] *Third Avenue Transit Corporation* (S. D. N. Y. 1958) 159 F. Supp. 440, 443.

[4] *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea* (2 C. A. 1959) 266 F. 2d 862, 868, cert. den. 361 U. S. 862.

> "Since Frank and Hernon acted as 'representatives' of their group of friends, and thus of all the preferred stockholders, they must be denied compensation under the statute and their petition must be dismissed. *Of course this does not mean that their activity was improper.*" [Emphasis added.]

In the opinion of Judge Caffey in *In re Republic Gas Corporation* (S. D. N. Y. 1936) 35 F. Supp. 300, on which petitioners so largely rely, appears this passage (p. 306):

> "It is perhaps unnecessary to add, but out of abundance of caution I wish to add, that nothing I have said is intended in any way to reflect on the personal integrity of those who have been denied compensation."

In view of the harshness of the application of §249 in cases where it does apply, it would seem quite unnecessary to extend the statute to a salaried employee not within the statute's language or intent.

POINT IV.

Whether the District Court might have discharged respondent in an exercise of discretion is not before this Court for review, since that court did not purport to exercise a discretion. At all events, subsequent decisions exonerated respondent of all of the charges improperly made against him here.

In deciding on June 14, 1960, that §249 mandated Fried's discharge because he had traded in the stock of the Debtor, the District Court in effect severed that issue from a welter of charges of fraud and misconduct contained in a succession of petitions and amended petitions [R 245]. The

Court expressly held "that anything beyond violation of §249 of the Bankruptcy Act was moot" [R 257]. Hence, the District Court did not consider whether Fried's compensation should, or should not be terminated in the exercise of discretion. Accordingly, that question was not before the Court of Appeals* and is not before this Court.

The other charges made by the Wolf petitions were set down for hearing on September 26, 1960 [R 250-7]. When this hearing was held, the matter of Fried's discharge under the supposed requirement of §249 had been disposed of long previously. While these other charges are wholly irrelevant, it is only just to point out that, despite repeated efforts to capitalize on them in petitioners' brief, they have all been judicially determined adversely to petitioners in later decisions.

The matters dealt with by the District Court at the subsequent hearing are as follows:

Fried is the president and principal stockholder of Nazareth Enterprises, Inc., a corporation wholly independent of the Debtor. The Debtor's fairgrounds is under lease (or license) to Enterprises [R 556], which operates an automobile race track there. The lease, which predates the filing of the Chapter X petition [R 407], requires the

* It is well settled that an appellate court may only pass upon such questions as were determined below and that, where a case has been erroneously decided as a matter of law, it will not be affirmed because the Court below should have reached the same conclusion as a matter of discretion. *Purcell* v. *Summers* (4 C. A. 1942) 126 F. 2d 390, cert. den. 317 U. S. 640; *Bergin* v. *Kiron State Bank* (8 C. A. 1944) 145 F. 2d 189; *Fanning* v. *Williams* (9 C. A. 1949) 173 F. 2d 95; and *Maryland Casualty Co.* v. *United Corporation* (1 C. A. 1940) 111 F. 2d 443. In the case last cited the Court said, per Magruder, C. J., (p. 446):

> "Since the complaint was dismissed on the mistaken ground of lack of jurisdiction, the judgment appealed from should not be affirmed, even if there existed adequate grounds on which the complaint might have been dismissed as a matter of discretion."

lessee Enterprises to pay as rent 12% of the gross admissions, with the proviso that, on those days that the lessee operates the food concessions for the races, it must pay 15% of the gross admissions [R 560].

J & J Foods, Inc. is wholly owned by one LaGrotte and his wife, who are its only officers. It has an agreement with the Debtor giving it the exclusive privilege to sell foods on the Debtor's premises except on those days that automobile races are held [R 505]. In 1955, Enterprises made arrangements with J & J Foods, Inc., whereby the latter was granted the right to purvey food and drink at the races [R 415] in consideration for which it was to pay a percentage fee to Enterprises. The effect of this arrangement was to bring into operation the escalator clause of the lease increasing Enterprises' rental to 15%.

In 1956, Weinstein, as president of the Debtor, and Fried, for Enterprises, agreed orally to a modification of the lease whereby the rental would be reduced to 10% of the gross admissions, upon condition that Enterprises would increase the prize moneys paid to the contestants in the automobile races. The lower rate was to obtain for each racing day that the prize moneys exceeded $1500. It was anticipated that such increased prize moneys would attract better-known drivers as participants in the races, and this, in turn, would stimulate greater spectator interest and result in increased admissions, thus increasing the rentals to be paid to the Debtor. The modification was to take effect at the beginning of the 1957 racing season [S. M. 11913, 12199-200; record below 15937, 16222-3], and was to continue at the Debtor's pleasure [S. M. 11939-40; record below 15963-4]. Upon the assumption that the modification was a transaction in the normal course of the Debtor's business, no Court order approving it was sought or obtained. Thereafter, Enterprises continued to operate

under the modification. During the years 1957-1961, inclusive, Enterprises increased its purses by an aggregate of $59,362. Gross paid admissions rose from $49,300.74 in 1956 to $122,363.76 in 1961. Rentals paid the Debtor increased from $5,708.64 in 1956 to $12,663.07 in 1961 [App. A to Petitioners' Brief].

After extensive hearings, the District Court on June 28, 1961, rendered its decision [R 265], disposing of the several matters then before it as follows:

(a) It found no fraud in the execution of the lease;

(b) It found no diversion from the Debtor of any rental either by Fried or by Weinstein;

(c) It found no diversion of any moneys owing to the Debtor by virtue of the J & J Foods, Inc. transactions;

(d) It found that it would not be in the best interests of the Debtor to reject the lease;

(e) It absolved Weinstein of any liability whatsoever; and

(f) It found that the modification of the lease was invalid, solely because there was no previous order of the Court authorizing it. Accordingly, the Court directed Enterprises and, upon its failure, Fried as its "alter ego", to account to the Debtor for the difference between the rent actually paid and 15% of the gross admissions during the years in question (thus, in effect, rescinding the modification). "The basis of the assessment against Nazareth Enterprises, Inc. and upon its default Fried, of the difference between the rental paid and the rental due beginning with the 1957 season is predicated solely upon the failure to obtain the court's approval. * * *." [R 277].

On September 12, 1961, the Court entered an order upon its decision which, among other things, directed the account-

ing. Appeals from that order were taken to the Court of Appeals (a) by Enterprises and Fried to the extent that it rejected the modification of the lease, determined liability on their part and directed them to account; and (b) by petitioners to the extent that it found no fraud, absolved Weinstein from liability and found no liability by reason of the J & J Foods, Inc. transactions, and refused to cancel or reject the lease.

Thus, when the District Court had concluded its consideration of this second controversy, Fried and Weinstein had been exonerated, and an accounting of the rents had been ordered, solely because this modification, so highly advantageous to the Debtor, had not been submitted to the District Court in advance. This decision, carrying with it no implication of fraud, double dealing or misconduct on the part of Fried or Weinstein, is the shaky pedestal from which petitioners exhort this Court to high standards, inveigh against sin generally, blackguard respondents in such terms as "diversion of rents", "overreaching", "misconduct", "deliberate wrongdoing", "fraudulent or dishonest acts", "self-dealing" and "faithless fiduciaries", and publish in the appendix to their brief (p. 203A) as applicable to this case the penal statute against embezzlement.

But even this inadequate prop for abusive irrelevancies has fallen. The District Court's order for the accounting was reversed by the Court of Appeals[1] on May 4, 1962, a full six months before petitioners' brief was filed here. No petition for *certiorari* has been addressed to this decision of the Court of Appeals, and the time to do so has long since expired.

Except in the wild and disproven allegations of Wolf's many petitions before the District Court there is no foun-

[1] *Wolf* v. *Nazareth Enterprises, Inc., et al.*, 303 F. 2d 152.

dation whatever for the inexcusable charge of fraud and misconduct against Fried with which petitioners' brief is replete.[1]

Petitioners' flank approach upon a simple question of statutory construction suggests that petitioners are uncertain but that, after all, the Court of Appeals may have been right. That court properly ignored the unwarranted and sinister attack.

Conclusion.

The Court of Appeals correctly construed the statute and should be affirmed.

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[1] In fact the whole attack on Fried's and Weinstein's purchases is insincere. The shares purchased by them were so purchased to prevent a raid on the Debtor's stock by the very persons so piously now complaining of Fried's and Weinstein's conduct. One of Fried's purchases was actually triggered by information that Mr. Robbins, the present counsel for petitioners, had himself solicited the purchase of those shares [R 476]. Indeed, $50,000 had been placed in his account by a member of the Wolf group for the purpose of buying the Debtor's stock [R 296]. And, concededly, one member of the Wolf group, Philip, while the treasurer and a director of the Debtor-in-Possession during the period of the reorganization, along with the other members of the Wolf group acquired a beneficial interest in the Debtor's stock [Pet. Br. 8, 9; R 227, 575-6, 583].

CASE TWO

(No. 27,000)

Question Presented.

Where none of the Debtor's stock has been issued in the usual manner, but its property has been acquired with a portion of funds entrusted to the president for investment in the project which became the Debtor, and the president has distributed the Debtor's stock certificates, not only to such investors, but also to his creditors in payment of, or security for his unrelated personal obligations to them, are the latter in a reorganization court entitled to share with the former in the Debtor's stock?

Statement of the Case.

This is a controversy between persons who gave one John Malakoff moneys to invest in the Debtor's capital stock (hereafter "the investors") and personal creditors of Malakoff (hereafter "non-investors"), who did not intend to invest in the Debtor, but who received certificates of stock from Malakoff as security for, or in payment of, unrelated transactions. Malakoff in *Ponzi* fashion* had distributed "dividends" to the investors, no doubt from their own funds.

The District Court allotted the capital stock of the Debtor to both classes of claimants. The Court of Appeals reversed, allotting the stock of the Debtor to the investors only. The Debtor's charter had authorized 200 shares; Malakoff had distributed certificates for 316. Neither Court made its allotment in accordance with the certificates that had been issued. The District Court's allotment was upon a

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* *Cunningham* v. *Brown* (1924) 265 U. S. 1.

"net fair value of the investment in the Debtor" which, in the case of the non-investors, meant Malakoff's personal indebtedness to the stock claimant. The District Court charged each investor with the dividends that he had received. The Court of Appeals, allowing only the claims of the investors, did not reduce their participation by the amount of the dividends, but did direct that the shares to be issued to the investors should be subject to a lien, in the amount of such dividends, in favor of the corporation.

Respondent Fried is a member of the group designated above as investors and, accordingly, this brief is submitted in support of the decision of the Court of Appeals.

The detail of petitioners' statement of the case is for the most part acceptable to respondent. A few matters require emphasis, and others slight correction.

A "Philadelphia Group" caused the Debtor to be incorporated in Pennsylvania on August 1, 1951 [R 53]. Kipling Realty Co., a corporation controlled by the Philadelphia Group, on September 26, 1951, conveyed the Market property, subject to $18,000 in mortgages, to the Debtor (not to Malakoff) [R 54]. The price was $100 plus the assumption by the Debtor (not by Malakoff) of $57,135.92, representing the cash expenditures of the Philadelphia Group in the acquisition of the property, and for improvements. On October 17th Malakoff agreed with two members of the Philadelphia Group to pay $32,853.08 for the 20 shares of the Debtor's stock then outstanding, under an installment contract which provided that the stock was to be held by the sellers until payment was made [R 55].

It is a fair inference that the only payments made upon either of these obligations, i.e.: the assumption by the Debtor of the purchase price $57,135.92, and the obligation of Malakoff to pay for the 20 shares transferred to him, came from the funds of the investors.

Between March 14, 1951 and March 25, 1953, Malakoff collected from investors in the Nazareth project, which became the Debtor corporation, $160,362.34. Between June 26, 1951 and February 15, 1952, Malakoff paid to the Philadelphia Group $49,489 and, for the improvement of the Market property, $9,507, a total of $58,996 (Schedules A and B appended hereto)*. Malakoff also paid $11,032.84 to the Philadelphia Group. This payment, however, represents the insurance proceeds of windstorm damage sustained by the Debtor [R 57]. It was not his money.

Not all of these payments can be traced to the funds given Malakoff for investment. However, the fact as found [R 190], that Malakoff did not make a practice of investing his own funds, but obtained financing from others, the fact that he "always needed money" [R 296], the fact that he received the money of the investors for the express purpose of investment in the project, and the fact that Malakoff's payments to the Philadelphia Group always followed and never anticipated collections from the investors [Schedules A and B], enabled the Court of Appeals to find [R 589, 593] that the moneys expended for the acquisition of the Market by the Debtor were the moneys of the investors.

There was at the time of the filing of the reorganization petition a balance of $29,467.16 still due the Philadelphia Group either from the Debtor for the property, or Malakoff for the stock. That Group has not filed any proof of claim in this proceeding. Edward Malakoff stated in court that the Group did not intend to assert the indebtedness against the Debtor [R 57].

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* These schedules, compiled from original exhibits in the District Court, are also part of the record.

Malakoff was given possession of the Market from about the time of the inception of the corporation [R 52]. He did not, however, receive the 20 shares he had agreed to purchase, or the corporate books and records, until December 1952 [R 56]. Commencing February 2, 1953 [R 50], he distributed certificates of stock of the Debtor to investors whose funds he already held, to other investors who paid him for their stock later, and also to his personal creditors in payment of, or as security for his obligations to them in unrelated transactions.

At the denouement in June 1953, Malakoff turned his 20 shares back to the corporation together with a formal release of any and all claims against the Debtor [R. 57, 554-5].

There is nothing in the acquisition by the Debtor of the Market property, or by Malakoff of the original 20 shares, which would indicate that the capital stock of the Debtor ever actually belonged to Malakoff. Moreover, Malakoff, in his dealings with the investors, never himself claimed a beneficial interest in the capital stock of the Debtor. The earlier investments he purported to hold "in escrow" until the shares were available [R. 566, 568-9]. Most of the investors received from Malakoff a letter form of receipt which provided in part as follows [R. 186]:

> "You understand, of course, that all of the authorized stock of The Nazareth Farmers and Auction Market Inc. [sic] which owns the Market has been issued to me. Under our arrangements, I am obliged to you for a proportionate share of my earnings, dividends, liquidating or otherwise and profits from the Market as I receive them."

Here is a clear declaration of trust by Malakoff for the benefit of the investors. Thus, even if all of the authorized

stock be treated as having been issued to Malakoff, there was no claim on his part to a beneficial interest in it, but only to hold it as trustee for the investors. In no case did Malakoff have an interest which he could transfer to his creditors.

The claims of the 41 stock claimants were filed [R 45] pursuant to §196 of the Bankruptcy Act (11 U. S. C. 596). The Debtor objected to each claim. In addition, the so-called Margolis Group which included Ida May Margolis and William McK. Shongut, who have been recognized by the Court of Appeals as investors entitled to a stock interest [R 598], filed objections to all of the claims except those in that group. Thus, their objections were filed to the non-investors Kanter [R 58]; Danciger [R 146]; Manoochehrian [R 165]; Harry Forman [R 136]; Katzenell [R 177]; Seymour Forman [R 159].

Synopsis of Argument.

No conflict between federal and state law is presented. Neither New York nor Pennsylvania law imposes any obstacle to recognizing as shareholders of the Debtor those who bought and paid for their stock. Neither New York nor Pennsylvania law requires them to share the Debtor's capital stock with those to whom the promoter gave certificates as security for, or in payment of, his personal unrelated obligations.

Petitioners read into the opinion of the Court of Appeals a resolution of the controversy by "general or federal equity" when they say state law was available and should have been applied. The petitioners themselves walk a tight rope, leaning at one time toward New York and, at another, toward Pennsylvania.

Petitioners do not dispute the right of the investors to share in the Debtor's capital stock. They object, however, to this participation being based upon the financial contributions that the investors have made. Upon this point, they choose New York law. No trust can be raised, they say, in favor of the investors, because resulting trusts in real property have been abolished by § 94 of the New York Real Property Law. Petitioners claim that the non-investors cannot be excluded from participating in the Debtor's capital stock. For this contention they choose Pennsylvania law. None can be excluded, they say, because Pennsylvania lacks the remedy of equitable cancellation of illegally issued stock. In both instances they are wrong. The New York statute does not apply. Pennsylvania does not lack the equitable remedy of cancellation. Even if it did, this would be immaterial since § 196 of the Bankruptcy Act requires "proof * * * of the interests of stockholders", and the non-investors claims are not proven by a showing that the certificates were issued in violation of the Pennsylvania Constitution and statute.

The Debtor's capital stock came into existence with the acquisition by the Debtor of the Market. This acquisition, which is the only legitimate basis for the issuance of stock, was procured by the money with which the investors supplied Malakoff. Equity, both the New York and Pennsylvania brand, will impress, not on the Market, but on the Debtor's capital stock a trust for the benefit of the investors. To the objection that only those who contributed before the Market was acquired may benefit by such a trust, the answer is that all of the subscriptions were made through Malakoff; that even before he became president on October 17, 1951, he was permitted to act as the corporation's agent and, under well-established equitable prin-

ciples, the corporation is estopped as against these investors to assert that their money never actually came into the treasury.

The determination of the stock interests is not complicated, as petitioners would have it, by questions which might arise upon an over-issue. With the non-investors eliminated, there is no over-issue.

In apportioning the Debtor's capital stock between the investors in the amounts of their respective contributions, and subjecting their shares to a lien for dividends improperly paid, the Court of Appeals has properly fashioned an equitable remedy to meet the situation.

POINT I.

The capital stock of the Debtor belongs to the investors.

A. The right of the investors to share is not disputed.

None of the certificates of stock now presented by the stock claimants were issued in the regular manner. Checks were drawn to Malakoff personally and not to the corporation, and none of the money was paid directly into a bank account of the corporation. No one, however, disputes the right of the persons who paid their money to Malakoff as an investment in the project to share in the Debtor's capital stock. The Commonwealth of Pennsylvania has claimed no escheat. The legal representatives of Malakoff make no claim. Even petitioners would permit the investors to share in the capital stock, and only object to a basis of such sharing which would exclude the non-investors.

It seems only reasonable that those who put up their money for a share in the enterprise should be recognized as the owners of the Debtor's capital stock. If doctrinal support is necessary, it is found in the equitable principles both of a resulting trust and of estoppel.

B. A trust is properly impressed upon the Debtor's capital stock for the benefit of the investors, since it was their money which enabled the corporation to acquire the Market, the only consideration for the issuance of shares in that stock.

In disputing the availability of a resulting trust, petitioners choose New York law, which, they say, is applicable because of the "center of gravity" rule (Brief 75-7).

A trust in favor of the investors is fully authorized by New York law.

On September 26, 1951, the Debtor acquired the Market property from Kipling Realty Co., a corporation controlled by the Philadelphia Group [R 54]. For that acquisition, Malakoff paid the Philadelphia Group $58,996, which the Court of Appeals has found came from moneys paid him by the investors aggregating $160,362.35 (Schedules A and B annexed). The only consideration for which the stock of the Debtor could have lawfully been issued was the Market property, since that is the only asset that the corporation acquired.

"A constructive trust is the formula through which the conscience of equity finds expression."* While the present facts bear more of the characteristics of a resulting than of a constructive trust, unquestionably the New York courts would impose a trust for the benefit of the investors. This trust would be imposed, not upon the real property, as

* Cardozo, J., in *Beatty v. Guggenheim Exploration Co.* (1919) 225 N. Y. 380, 386.

petitioners seem to assume [Brief 74], but upon the Debtor's capital stock.*

Contrary to petitioners' contention [Brief 45, 110] New York Real Property Law §94 poses no barrier to the fixing of a trust on the Debtor's capital stock for the benefit of those who paid for it. There are two reasons:

(1) The statute does not apply to personal property. *Robbins* v. *Robbins* (1882) 89 N. Y. 251; *Coleman* v. *Mulligan* (N. Y. Sp. 1946) 66 N. Y. S. 2d 696.

(2) As put by Cardozo, Ch. J., in *Foreman* v. *Foreman* (1929) 251 N. Y. 237, 241:

> "Nothing in the statute as to the implication of resulting trusts is at war with this conclusion (Real Prop. Law, §94). The statute has put an end to the rule at common law that where a grant is made to one for a consideration paid by another a trust results inevitably and always, by force merely of the payment, irrespective of intention (*Garfield* v. *Hatmaker*, 15 N. Y. 475, 477; Scott, Resulting Trusts in Purchase of Land, 40 Harv. L. Rev. 675). The conveyance is operative according to its terms if nothing else is proved. The statute has no effect, however, on trusts constructively imposed as a consequence not of payment alone, but of payment in combination

* A distinction must be taken here between the capital stock of a corporation and the certificates representing its shares. "The moment a corporation has either franchises or property of any kind it has stock; • • •". *Burr* v. *Wilcox* (1860) 22 N. Y. 551, 556. The capital stock is "• • • the thing of real value, the money or property of the corporation put in to make up its capital, while a certificate of stock is but the evidence of an ownership of a part or share of the capital stock." *Parsons* v. *Ley* (Onondaga Sp. T. 1933) 158 N. Y. Misc. 32, aff'd. 243 A. D. 681, aff'd. 269 N. Y. 630. In the present case the Court of Appeals could not void the capital stock. All it did was to disregard certificates as conclusive evidence of stock ownership in determining stock claims. Here it might be said that the Market on arrival at the corporation was converted from real to personal property.

with other or extrinsic equities. As to this the decisions are uniform and ample. 'It is only the common-law trust for the benefit of an individual from whom the consideration for a grant issues, and resulting from the fact of payment of the consideration, and having no other foundation, that the statute abolishes' (*Carr* v. *Carr*, 52 N. Y. 251, 260; [other citations omitted]).

"Enough and ample there is here to put the case for the plaintiff in the field uncovered by the statute. His equity does not grow out of payment and nothing more. It is reinforced by words of promise, by the relation of man and wife, and by unequivocal acts of confirmation and performance. In such circumstances, the plastic remedies of the chancery are moulded to the needs of justice."

Here, even if the subject were real property, there is more than the mere fact of title in one and payment by another. The investors' equity "is reinforced by words of promise" and by the relation between the parties. The letter receipt reads in part [R 186]:

> "Under our arrangements, I am obliged to you for a proportionate share of my earnings, dividends, liquidating or otherwise, and profits from the Market as I receive them."

But the investors' equity is also reinforced "by unequivocal acts of confirmation and performance". Original issue of stock certificates were actually given them.

§94 of the New York Real Property Law has no counterpart in Pennsylvania. Petitioners concede that a resulting trust may be imposed in Pennsylvania [Brief 45],* but merely contend that it could not inure to the benefit of the investors who paid Malakoff for their stock interests

* See *Zahorsky* v. *Leschinsky* (1959) 394 Pa. 368, 127 A. 2d 362.

after February 15, 1952, when Malakoff ceased making payments to the Philadelphia Group for the Market.

C. The Debtor is estopped to deny membership in the corporation to those who invested with Malakoff, since he was acting within the scope of his authority as agent of the corporation.

Malakoff had been president of the Debtor since October 17, 1951 [R 56]. The By-Laws provided [Saul: Ex. I]:

> "[V]4. The President shall be the chief executive officer of the corporation; * * * he shall have general and active management of the business of the corporation, * * * and shall have the general powers and duties of supervision and management usually vested in the office of President of a corporation."

Before Malakoff was elected president, and from the very inception of the corporation on August 1, 1951, he had been its agent in charge of its affairs [R 52, 56]. Those who gave their money to Malakoff for investment were thus dealing with the chief executive officer of the corporation, or with its authorized agent, with whom investors and others having business with the corporation might properly deal. The investors each paid money in reliance upon the agent's representation that they were buying stock in the corporation. Under such circumstances the corporation is estopped to deny the authority of the agent to represent it. Such is the law in Pennsylvania which petitioners say governs the rights of stockholders *vis-a-vis* the corporation (Brief 72). *Appeal of Kisterbock* (1889) 127 Pa. 601, 18 A. 381. And in New York also, *NY & NH RR Co.* v. *Schuyler* (1855), 34 N. Y. 30. In *Krall* v. *Lebanon Valley Savings & Loan Association* (1923), 277 Pa. 440, 121 A.

405, the Court directed defendant corporation to recognize as valid shares of its stock issued to plaintiff for moneys paid to the corporation's treasurer, who had embezzled them. The Court said (p. 406):

> "Payment to the treasurer, on the facts in this case, may be considered payment to the association, regardless of what he did with the money; * * *."

The availability of an estoppel to all who made an investment through Malakoff after August 1, 1951, eliminates from the case the question whether those who invested with him after he ceased making payments for the acquisition of the Market on February 15, 1952*, may share with the earlier subscribers in the trust of the corporation's capital stock.

Petitioners claim [Brief 46, 105] that the investors cannot make proof of estoppel *vis-a-vis* the Debtor because they were put on notice that they were dealing not with the Debtor, but with Malakoff individually. For this they rely (1) on the fact that checks were made payable to Malakoff; and (2) upon the form of letter-receipt which the Examiner found [R 186] that most of the investors received. But the assertion "Malakoff openly professed to own all the stock himself" [Brief 105], is due to a failure to read the letter-receipt closely. That document says [R 186]:

> "You understand, of course, that all of the authorized stock of The Nazareth Farmers and Auction Market Inc. [sic] which owns the Market has been issued to me. Under our arrangements, I am obliged to you for a proportionate share of my earnings, dividends, liquidating or otherwise and profits from the Market as I receive them."

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* On this date a substantial part of the total moneys to be paid the Philadelphia Group remained unpaid.

Here is not the slightest suggestion that the investors are dealing with Malakoff as a seller. On the contrary, if all of the 200 authorized shares of stock of the Debtor had actually been issued to Malakoff, here is a declaration by Malakoff that those shares were being held by him in trust for the benefit of the investors. Of course, all of the authorized stock had not been issued to Malakoff. His representation is not that he is selling to the investors shares previously issued to him. The representation is in effect that, as agent of the corporation, Malakoff is issuing to himself, as agent for the investors*, the entire 200 shares of Nazareth.

The drawing of the checks to Malakoff rather than to the corporation is sufficiently explained by a further provision of the receipt [R 187]:

> "On the other hand, I may cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your . . . shares will be applied as your contribution with a corresponding proportionate interest."

There is nothing, therefore, in either of these circumstances which should lead the investors to the belief that the money they had entrusted to Malakoff was not to be paid into the corporation or that he proposed to steal it.

D. The Debtor is not estopped to deny membership to those who dealt with Malakoff as an individual.

No such recognition need be given the creditors of Malakoff. They did not give him money for investment, but are counting on an antecedent indebtedness of Malakoff to

* There is, of course, no legal obstacle to Malakoff representing both the corporation and the individual investor, or one of them for part of the transaction and the other for the remainder. Restatement Agency, 2d Ed., §14 L., p. 76.

them as consideration for the issuance of the shares. The report of the Examiner gave recognition to those persons because of a provision in the Uniform Stock Transfer Act which validates a transfer for an antecedent indebtedness [R 202]. What is involved here, however, is not the consideration for a contract or for a transfer; it is the prejudice or detriment which will support estoppel.*

Judge Learned Hand in *Helvering* v. *Schine Chain Theatres, Inc.* (2 C.A. 1941) 121 F. 2d 948, 950, said:

> "But it is not necessary to reassert those rulings here, because there was no basis for an 'estoppel,' however broadly one uses that disastrous word. This is true because, however nebulous, it has always had at least this solid centre; that the party who invokes it shall have acted to his detriment in reliance upon what the other party has done. That was not the case here."

Appeal of Kisterbock, supra, is directly in point. There, the Supreme Court of Pennsylvania said (p. 383):

> "There is no finding that Elbert ever advanced any money on the shares delivered to Kisterbock either to Morton or to any one else. There is not even a finding that they were delivered to Elbert as security for an antecedent indebtedness due by Morton to him or even that there was such indebtedness. But if there had been such a finding, or if such had been the fact, Elbert would not have been entitled to any relief on that account as against the company, because, in that event, Elbert parted with nothing on the faith of the certificates, and he would fail to bring

* Under provisions of the New York Stock Corporation Law similar to those of Pennsylvania, stock may not be issued for an antecedent indebtedness of the corporation itself. *In re Paul Delaney Co., Inc.* (W. D. N. Y. 1927) 23 F. 2d 737; *In re Progressive Wall Paper Corp.* (2 C. A. 1916) 229 F. 489. *A fortiori* the stock could not be issued for a past indebtednes of an officer.

himself within the principle upon which alone indemnity could be given, * * *."

To invoke an estoppel, therefore, the stock claimant must have taken a step to his detriment in reliance on the representations of Malakoff. In the case of the investors, this is manifest. They parted with their money. In the case of the others, they were as well or as badly off after receiving the stock certificates as they were before.

Furthermore, the Debtor is compelled to accept claimants as stockholders only if they dealt with Malakoff as agent of the corporation. When he solicited and received moneys for investment in the corporation he was acting as the corporation's agent and the corporation became responsible for his acts. *New York and New Haven R. R. Co.* v. *Schuyler* (1865) 34 N. Y. 30, at p. 50. On the other hand, where the claimant received what purported to be the original issue of stock of the corporation in a transaction or series of transactions with Malakoff personally, the Debtor incurred no liability to the claimants. In *Manhattan Life Insurance Company* v. *The Forty-Second Street Company* (1893) 139 N. Y. 146, the Court, per Maynard, J., said (p. 151):

> "But, without determining what are the duties of the officers of a corporation, when called upon to respond to the inquiries of intending purchasers of the stock, there is a sufficient reason why the plaintiff cannot avail himself of the representations of Allen in regard to the genuineness of this certificate. They were made in a private and personal transaction, undertaken for his individual benefit, and so understood by the plaintiff. The plaintiff knew that Allen, in the negotiation of the loan, was not acting as the officer or agent of the defendant, or in its behalf, and that his personal interest in the transaction

might lead him to betray his principal. It is an old doctrine, from which there has never been any departure, that an agent cannot bind his principal, even in matters touching his agency, where he is known to be acting for himself, or to have an adverse interest."

POINT II

Non-investors who received stock certificates in payment of, or as security for Malakoff's personal and unrelated obligations, may not be recognized as having a stock interest in the Debtor.

A. The certificates which petitioners hold were illegally issued and, therefore, cannot participate in the bankruptcy reorganization, irrespective of the Debtor's remedy under Pennsylvania law.

The jurisdiction of the Bankruptcy Court has continuously attached since 1953 and the Debtor is still plodding its way toward a reorganization. The fact that successful management by Weinstein and Fried has now given a substantial value to the stock does not take the Debtor out of the operation of the Bankruptcy Act. In order to share in the reorganized corporation which is to emerge it is necessary for petitioners to establish their interests as stockholders in the coming reorganization.

The Bankruptcy Act provides:

> "Sec. 196. After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the court."

Thus, the claims of petitioners to interests as stockholders had to be, and were filed and, since they were challenged [R 45], had to be proved. According to *In re American Fuel & Power Co.* (6 C. A. 1941) 122 F. 2d 223, appeal dismissed 322 U. S. 379 (p. 229):

> "The claim of a creditor or the interest of a stockholder which is invalid because it is based on or arises out of an illegal or criminal transaction, is not provable or allowable in bankruptcy reorganizations."

As governing the relationship of the non-investors to the Debtor, petitioners (Brief 73) choose Pennsylvania law. But the substantive law of Pennsylvania in Constitution and statute clearly excludes the non-investors from participation in the capital stock of the Debtor.

The issuance of certificates of stock to petitioners was an illegal transaction. The Debtor is a Pennsylvania corporation. The Constitution of Pennsylvania, Article XVI, §7, provides:

> "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void".

The Constitution, it is true, is not self-executing. But at all times material here, the Constitution has been implemented by the Act of May 5, 1933, P. L. 364, 15 Purdon's Stats. Ann. §2852-603, which both before and after the amendment of July 11, 1957 (P. L. 711, §1) provided in part as follows:

> "Shares of a business corporation shall not be issued except for money, labor done, or money or property actually received."

After citing the forerunner of this section, this Court, in *McCandless* v. *Furlaud* (1935) 296 U. S. 140, said, per Cardozo, J: (p. 161):

> "There are decisions in Pennsylvania that the Constitution is not self-executing. *Grange National Bank* v. *Collman*, 306 Pa. 200; 159 Atl. 26. That holding is irrelevant as to corporations such as this one, for there exists as to them an 'implementing' statute (Purdon's Penna. Stats., *supra**), without restriction as to the form of remedy."

The same Act in § 2852-610 provides:

> "The fact that shares are issued in violation of, or without full compliance with, the provisions of this act shall not make the shares so issued invalid, unless they are issued in violation of Article XVI, Section seven, of the Constitution of this Commonwealth."

Thus, the issuance of the stock certificates held by petitioners was illegal both by Constitution and by implementing statute.

By a clever juxtaposition of the parties, petitioners claim that, on the faith of the pieces of paper that they hold, they may intrude into the reorganization of the Debtor to which they have neither contributed nor intended to contribute money, labor or property. Under Pennsylvania law, they say, stock illegally issued may not be canceled. The only remedy left to a corporation which has thus been intruded upon is by call and assessment, and by foreclosure

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* This Court refers to Act of April 17, 1876, P. L. 30, 32, §4, Purdon's Pa. Stats. Title 15, §131, which read "* * * no such corporation shall issue either bonds or stock except for money, labor done or money or property actually received and all fictitious increase of stock or indebtedness in any form shall be void; * * *". This section was superseded by §2852-603 quoted above at the time of the enactment of the Business Corporation Law of May 5, 1933.

on the stock for the benefit of the corporation. Happily for them, they say, the District Court has already dismissed counterclaims of the Debtor for the subscription price. With this determination as *res judicata* [Brief 42-44]*, they can laugh at the futility of the judicial process, and retain a stock interest in the corporation as a windfall.

The difficulty with this clever solution is not only that it is based upon a false premise [B, *infra*], but that it has transposed the position of the parties. It is quite irrelevant whether a Pennsylvania court could grant the equitable remedy of cancellation at the suit of the corporation or of a complaining stockholder. The Debtor here is not looking for a remedy, and needs none. Despite the repeated statements in the brief, the Court of Appeals has not decreed cancellation of any shares.

What has happened is that petitioners have failed to establish such stockholding in the Debtor as will entitle them to participate in the coming reorganization. For this purpose, the Debtor-in-Possession (as trustee) is cast in the role, not of plaintiff but of defendant.** In that capacity it may defend on the ground that the stock has been issued contrary to Constitution and statute. Petitioners cannot establish their interest upon the fact that they received the stock certificates in payment of, or as security for an obligation owed by the promoter in a transaction in which the corporation got nothing.

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* There is no *res judicata*. The District Court, having granted petitioners' stock claims, had no recourse but to dismiss the counterclaims for the subscription price. These could only have been allowed if the Court had found there was no consideration for the issuance of petitioners' shares. Should this Court hold that the shares were issued without consideration but petitioners are entitled to retain them, the issue whether they must now pay for them would be revived.

** Petitioners go at least half-way on this. They say [Brief 71]: "Here, the 36 stock-claimants are all plaintiffs (so to speak) competing for allowances in a limited pool of corporate stock; the Debtor is a nominal party."

True, under Pennsylvania law, the stockholder's *prima facie* case is his stock certificate in regular form [Brief 98], but in no instance does the case rest there. In each claim now in dispute, it was proved to the satisfaction of the Court of Appeals [R 591, 595-9], that petitioners had neither made nor intended to make any investment in the Debtor, and that the certificates that they received were in each case given them by the promoter in satisfaction of, or as security for his personal indebtedness to them in transactions wholly unrelated to the Debtor and its affairs.

B. It is not true that Pennsylvania lacks the remedy of equitable cancellation of stock unlawfully issued.

The cancellation of certificates of capital stock unlawfully issued is part of the equity jurisdiction which Pennsylvania has inherited in common with her sister states. Commencing with the Supreme Court of Alabama, *Crow* v. *Florence Ice & Coal Co.* (1905) 143 Ala. 541, 39 So. 401, the Court said (39 So. 402):

> "Equity jurisdiction to declare the issuance of fictitious stock in a corporation void, and to have the certificates representing such stock cancelled, cannot be questioned."

Recognition of the right of cancellation is overwhelming. *Diamond State Brewery, Inc.* v. *De La Rigaudiere* (1941) 25 Del. Ch. 257, 17 A. 2d 313; *Ellis* v. *Penn Beef Co.* (1911) 9 Del. Ch. 213, 80 A. 666; *McGhee* v. *Minor* (1939) 188 Ga. 635, 4 S. E. 2d 565; *Therm-O-Proof Insulation Mfg. Co.* v. *Hoffman* (1946) 329 Ill. App. 645, 69 N. E. 2d 725; *Gentilly Land Co.* v. *Crawford* (1954) 225 La. 837, 74 So. 2d 47; *Meier* v. *First Citizens Bankers Corp.* (1938) 301 Mass. 410, 17 N. E. 2d 106; *Koppitz-Melchers, Inc.* v. *Koppitz* (1946) 315 Mich. 582, 24 N. W. 2d 220; *B. & C. Electrical Construction*

Co. v. *Owen* (4th Dept. 1917) 176 App. Div. 399, aff'd. 227 N. Y. 569; *Evans* v. *Ideal Brick & Brickcrete Mfg. Co.* (Sup. Ct. Okla. 1955) 287 P. 2d 454; *McAlister* v. *Eclipse Oil Co.* (Tex. Civ. App. 1936) 92 S. W. 2d 545, reversed on other grounds 128 Tex. 449, 98 S. W. 2d 171 and *Floor* v. *Johnson* (1948) 114 Utah 313, 199 P. 2d 547.

It is therefore, not surprising to find that, despite petitioners' assertions to the contrary, Pennsylvania does not lack the equitable remedy of cancellation of stock certificates. In *Fraser Fund* v. *Fraser* (1944) 350 Pa. 553, 40 A. 2d 22, the court granted cancellation of stock issued in violation of a contract between stockholders. *A fortiori*, Pennsylvania would recognize the remedy of equitable cancellation of certificates issued in violation of Constitution and statute.* A cancellation of stock issued without consideration was granted in *Shipley* v. *Monticue Lines* (Com. Pleas Fayette Co., 1941) 4 Fayette Legal Journal 293. The remedy has also been granted in Federal Courts sitting in Pennsylvania: *Bingaman* v. *Commonwealth Trust Co.* (M. D. Pa. 1926) 15 F. 2d 119; *In re Chemical Lime Co.* (M. D. Pa. 1938) 25 F. Supp. 347.

In *Petrishen* v. *Westmoreland Finance Corporation* (1959) 394 Pa. 552, 147 A. 2d 392, the court below had granted cancellation of stock certificates upon the ground that they had been issued illegally. The Supreme Court reversed, not upon the ground that the court was without power to cancel the certificates, but because the contract of subscription, pursuant to which the stock had been issued,

* The Debtor-in-Possession is in position to take advantage of any right of cancellation Pennsylvania may afford. In each instance where the Court of Appeals disallowed a claim, not only the Debtor, but also the Margolis Group had filed objections to such claims. This group includes Shongut and Ida Margolis (R 45) whose claims were both allowed, at least in part, by the Court of Appeals (R 598). The group filed objections to Kanter (R 58); Danciger (R 146); Mahoochehrian (R 165); Harry Forman (R 136); Katzenell (R 177); Seymour Forman (R 159).

did not violate the Constitution or statute. In the rather full opinion there is not even a suggestion that the court was without power to cancel the stock if it should find that its issuance was illegal. Indeed, that question seems to have been determined by this Court in *McCandless* v. *Furlaud* (1935) 296 U. S. 140, 161, where it was said that Pennsylvania had an "implementing" statute "without restriction as to the form of remedy."

Petitioners rely upon *Fetter* v. *Delaware Valley R. R. Co.* (1903) 206 Pa. 485, 56 A. 57 and *Bradford County Telephone Co.* v. *Young* (1938) 329 Pa. 433, 198 A. 96, in both of which cases stockholders were denied the remedy of a cancellation of securities unlawfully issued. But in each case, the former under the Railroad Act and the latter under a Public Utility statute, the law had provided for such a suit by the Attorney General and it was held that that remedy was exclusive. In the case of a private corporation where no such remedy is given to the Attorney General, such a suit for cancellation is manifestly within the powers of a Pennsylvania court.

In *Bradford*, the Court was emphatic that the illegal issue of the securities could be asserted by the corporation as a defense, saying, per Stern, J. (p. 99):

> "Of course, this principle does not prevent such a corporation, or any other, under proper circumstances, in an action brought against it to recover payment of its bonds or mortgage, from defending on the ground that the securities were issued in violation of law." (Citing cases)

Hence there can be no question but that the Debtor may resist the attempt to establish reorganization interests upon illegal transactions, and may do so with the full concurrence of the Pennsylvania authorities.

C. The remedy of call and assessment on stock certificates was not intended as a substitute for cancellation of stock unlawfully issued.

To the suggestion that the machinery for realization of the subscription price is in Pennsylvania a substitute for cancellation of the stock certificates there are two ready answers:

(1) Petitioners never entered into any contract of subscription* for the shares they now seek to prove. In no case was a certificate received under an agreement to pay for it. In every case, except where it was accepted as security, the certificate was received as payment, and that ended the transaction. To any call or assessment petitioners could have replied that they had never subscribed.

Petitioners' cases are inapplicable.

In *Petrishen* v. *Westmoreland Finance Corporation* (1959) 394 Pa. 552, 147 A. 2d 392, the Court below had granted cancellation at the suit of a stockholder. The Supreme Court reversed, not because the action did not lie, but because the Court regarded the arrangement that the corporation made with its manager to procure his experienced services, whereby the stock was to be issued to him when the corporation's earnings amounted to $30,000, not violative of the constitutional provision. Similarly, in the Third Circuit case of *Grafton* v. *Masteller* (1956) 232 F. 2d 773, the Court held valid an agreement with the plaintiff whereby corporate shares were allotted to him, the certificate to be delivered to him when earnings upon the shares equaled the par value. By this agreement also, the services of plaintiff, an engineer, were procured for the corporation.

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* "Subscription" is a prerequisite to call and assessment. 15 Purdon Pa. Stat. §2852-604, 605.

Certainly, neither of these cases is authority for the proposition that corporate shares may be issued and delivered to satisfy the president's personal debts. Both in *Bell* v. *Aubel* (1943) 151 Pa. Super. 569, 30 A. 2d 617 and in *Grange National Bank* v. *Collman* (1932) 306 Pa. 201, 159 A. 26, it was held that the constitutional prohibition could not be interposed as a defense to a suit on a stock subscription. Manifestly, as these Courts pointed out, the constitutional provision was not intended as a shield whereby a subscriber might avoid his obligations. In these cases, of course, there were actual subscriptions. There could be little doubt that, if a situation were presented to a Pennsylvania court in which a certificate had been issued without any agreement to pay for it, the mere issue of the certificate, being to all intents and purposes a blank piece of paper,* could not support an action for assessment. Accordingly, it is entirely consistent with respondents' position in this case that the counterclaims against petitioners for the assessments, based upon contracts of subscriptions that they never made, should have been dismissed.

(2) Where stock is void at its issuance there can be no assessment.

The Constitutions of Arizona and of Oklahoma contain provisions similar to those of Pennsylvania with reference to the issuance of stock. In *Hirschfeld* v. *McKinley* (9 C. A. 1935) 78 F. 2d 124, cert. den. 297 U. S. 703, a bankruptcy trustee of an Arizona corporation sought to recover from a purported stockholder upon a call and assessment based

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* *Hirschfeld* v. *McKinley* (9 C. A. 1935) 78 F. 2d 124, cert. den. 297 U. S. 703; *B. & C. Electrical Construction Co.* v. *Owen* (4th Dept. 1917) 176 App. Div. 399, aff'd. 227 N. Y. 569. In the latter case the Court, in affirming a judgment cancelling a certificate for shares of stock which had been issued without valid consideration, said of that certificate (p. 400): "It was, in effect, like so much blank paper".

upon shares issued without consideration. The Court, in denying recovery, said (p. 134):

> "It would seem an anomaly for a court to order an assessment on corporate stock unless it believed that such stock was, for some purposes at least, valid."

And again (p. 135):

> "Accordingly, we hold that no action ex contractu can be maintained against the purported stockholders of the Hollander Drug Company, in the form of an assessment and call based upon the attempted issue of shares to them, for the reason that, at least as far as Dr. Craig was concerned, such issue was in direct contravention to the Constitution of Arizona and therefore was 'a blank piece of paper,' 'for all purposes,' 'as against any person' ".

Likewise, in *Stone* v. *Hudgens* (W. D. Okla. 1955) 129 F. Supp. 273, the Court, upon the ground that the stock had been issued in violation of the Oklahoma Constitution, denied a recovery to a trustee in bankruptcy seeking to enforce an assessment upon the stock.

In the neighboring state of Delaware, which is not unfamiliar with corporations and corporate procedure, it was said in *Bush* v. *Hillman Land Co.* (Ct. of Ch. 1938) 2 A. 2d 133, at p. 135:

> "It may well be true, as the demurrants contend, that if the stock was issued without consideration, it was not void but only avoidable, and that it was accordingly permissible for the corporation to pursue the remedies provided in the General Corporation Law to enforce payment thereon for the benefit of creditors [citing cases]; or it may be conceded arguendo without deciding, that assumpsit or trover would lie for the value of the stock. Even so, such remedies as those are in affirmance of the stock as

outstanding stock. The corporation has the right to insist, however, that the stock shall be stripped of its character of issued and outstanding stock."

POINT III.

The Court of Appeals in fixing the stock interests of the investors in accordance with the amounts invested acted well within the applicable powers of equity.

A. The decision below has eliminated any question of overissue.

The question what a corporation must do where there has been an overissue of its capital stock with respect to the overissued shares is not posed here. The certificates handed out represent a total of 316 shares. 200 shares were authorized. With the 166 eliminated which were illegally issued, there is no overissue.

B. The method of allocating stock interests between the investors works no injustice.

The Court of Appeals did not cancel the Debtor's shares. It merely failed to accept stock certificates as conclusive evidence of the respective stock interests. The Court of Appeals said [R 593]:

> "Greater equity will be achieved by calculating the allowed claims in terms of dollars rather than in invalidly issued shares."

Equity required this because in an original issue of shares the price should have been fixed by the board of directors and should have been the same for all. While most paid $1,000, some paid only $600, and some less

[R 593]. Furthermore, provision had to be made for the so-called "dividends" of 20% that had been paid by Malakoff and accepted on the basis of the amount invested [R 199]. In fixing the proportionate interest according to the investment, and providing for a lien in favor of the corporation for the so-called "dividends", the Court was molding its decree to the facts, as it should have done. "The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mold each decree to the necessities of the particular case".*

In *Getty* v. *Devlin* (1873) 54 N. Y. 403, shares of stock had been issued both to persons who had paid valuable consideration and to others who had paid nothing. The Court (p. 416) suggested as part of the relief "a redistribution of the stock among the *bona fide* subscribers alone", but left that as a matter of detail to the court below. Such a "redistribution" is the net result achieved by the court below in this case.

Petitioners argue that this method of allocation results in an unjust enrichment of the investors [Brief 48, 111]. Taking these dollar values, as the Court has found, as percentages of the Debtor's entire capital stock, petitioners say, for example, that Weinstein's stock interest is advanced from 3.5% (7 shares out of 200 authorized) to 4.79% [Brief 111]. But each of the investors might reasonably expect that, when all the shares had been sold, the total assets of the corporation at its inception would be $200,000. As against this, the corporation acquired real property at cost of $58,996 [Examiner's J, Saul] and, even if the forgiveness by the Philadelphia Group is added, of only $89,989 in all. No working capital went into the

* *Hecht Co.* v. *Bowles* (1944) 321 U. S. 321, 329. See also *Brown* v. *Board of Education* (1955) 349 U. S. 294, 300.

treasury. The small increase in the proportion of ownership, therefore, cannot be said to be a windfall.

C. No different provision need be made for the so-called Margolis Group.

The same principles which award stock interests to the investors and deny them to Malakoff's personal creditors apply to the claims of the Margolis Group. The Court of Appeals gave the same consideration to each of the Margolis claimants as it did to the others. Some it found to be investors, and allowed the claims; some it found to have received their shares in payment of Malakoff's personal debts, and disallowed their claims [R 597-8]. This group has not petitioned for *certiorari*.

Petitioners' bare statement [Brief 61] that they include the Margolis Group as respondents clearly affords no basis for delaying this reorganization further by sending these claims back to receive the same determination that they already have. At all events, not having petitioned for *certiorari*, the Margolis Group, both favored and unfavored, are deemed to have acquiesced in the decision of the Court of Appeals and, as to them, that decision is final.

Conclusion.

The Court of Appeals was not required to make a choice of law. Petitioners have failed to point out any rule of substantive law in either New York or Pennsylvania which runs contrary to the decision reached below. Under the law of both states, the investors are entitled to their investments in the Debtor by a clear resulting trust, if not, indeed, by an express trust. In any event, the Debtor, as against the investors, is estopped to deny validity to their stockholdings. The suggestion, if at all material, that Pennsylvania

lacks the remedy of an equitable cancellation of stock certificates, is simply incorrect. Pennsylvania has that remedy, and if the bankruptcy procedure had not intervened the corporation or the investing stockholders would have had it against the certificates held by Makakoff's creditors, for which it was never intended that the corporation receive any consideration.

The method of allotting the respective interests of the investors as between themselves, employed by the Court of Appeals, is well within the flexible powers of equity.

The decision of the Court of Appeals should be affirmed.

Dated: New York, N. Y.,
January 15, 1963.

Respectfully submitted,

HAROLD HARPER,
VINCENT P. UHLEIN,
Counsel for Respondent Jerome Fried.

SCHEDULE A

Payments by Nazareth Investors to John Malakoff from March 14, 1951 to March 25, 1953.

1951	Name	Claimants' Exhibit No.	Amount
Mar. 14	Samet	2	$ 1,500
Apr. 2	G. Klein	5	2,000
Apr. 10	Samet	2	500
Apr. 10	Kanter	5	2,667
Apr. 10	Kanter*		1,333
Apr. 10	Mintz	(Dr's. K m	4,000
Apr. 10	D. Graveson	(Saul	4,000
June 1	D. Clark	2	500
Aug. 1	B. Clark	2 & 3	3,000
Aug. 1	Masur	3	3,000
Aug. 1	B. Clark*		1,000
Aug. 14	F. Como*		4,000
Aug. 14	L. Como*		4,000
Aug. 25	Hull	3	2,400
Aug. 30	Bikales*		5,000
Sept. 1	J. Fried		2,000
Sept. 11	Treat	4	2,000
Sept. 12	Masur	4	400
Sept. 17	M. Klein	2	1,200
Sept. 18	Kane	5	2,000
Sept. 19	Weinstein	4	7,000
Sept. 19	Spielholtz	2	1,200
Sept. 20	Saul	4	3,000
Sept. 20	G. Klein	6	1,200
Sept. 29	D. Clark	2	1,125
Oct. 4	Hull	3	1,200
Oct. 18	Laupheimer	5	4,500
Oct. 18	Laupheimer*		500
Oct. 31	Bluestone	4	2,000
Nov. 2	Kane	6	1,000
Dec. 7	A. Fried	2	1,000
Dec. 20	Rosen	3	3,500
1952			
Jan. 4	Rosen	6	1,500
Jan. 7	A. Fried	3	1,000
Jan.	G. Klein*		500
Jan. 21**	G. Klein	7	2,300

* Payments made by cash.

** Total payments including this date $79,025.

1952	Name	Claimants' Exhibit No.	Amount
Mar. 5	Rosen	9	$ 1,000
Mar. 11	D. Clark	2	200
Mar. 27	D. Clark	2	500
Apr. 10	G. Klein	8	2,000
July 25	H. Schwartz	3	2,000
July 30	D. Clark	2	550
Oct. 20	A. Fried	3	1,000
Nov. 10	Masur	5	500
Nov. 15	G. Klein	4, 2	6,000
Dec. 12	Lapp heimer	4, 2	3,000
Dec. 14 & 15	Pollack	4	7,000
Dec. 16	Pollack	Cash	1,500
1953			
Jan. 14	G. Schwartz	4	2,000
Jan. 14	H. Schwartz	4	2,000
Jan. 25	Spielholtz	3	1,800
Feb. 2	F. Como	Cash	2,000
Feb. 2	L. Como	Cash	2,000
Feb. 17	Kaplan	2	1,000
Feb. 27	Bond	3	1,000
Mar. 1	P. Como	Cash	8,000
Mar. 16	Noire	3	5,000
Mar. 17	T. Schwartz	4	3,000
Mar. 20	H. Forman	7	6,000
Mar. 20	H. Forman	3	5,000
Mar. 25	Grossman	2	2,000
			$145,075

The above amount does not include the sum of $6,287.34 paid by William McK. Shongut during 1953, nor the sum of $9,000 paid by Ida May Margolis during 1951, as found by the Court of Appeals [R 598].

Schedule B.

Payments by John Malakoff to Edward Malakoff, et al. for Purchase of the Market Property [Examiner's J, Saul]

1951			
June	26	$ 3,750.00	
July	7	10,000.00	
Aug.	16	2,250.00	
Aug.	18	739.00	
Aug.	18	750.00	
Sept.	11	5,000.00	
Sept.	13	5,000.00	
Sept.	21	5,000.00	
Oct.	16	2,500.00	
Oct.	24	2,500.00	
Oct.	25	2,500.00	
Oct.	29	2,500.00	
Dec.	20	2,853.08	
1952			
Jan.	3	2,146.92	
Feb.	15	2,000.00	
			$ 49,489.00
Add: Payment in November, 1951, to Casper Simmers for Nazareth Improvements (Ex's BW, Saul Claim)			9,507.00
Total Payments by John Malakoff			$ 58,996.00

Recapitulation

Total Payments by Nazareth Investors to John Malakoff	$160,362.34
Total Payments by John Malakoff for Purchase of Market Property	$ 58,996.00
Excess received by John Malakoff	$101,366.34

APPENDIX.

Bankruptcy Act.

SEC. 188 [11 U. S. C. §588]. A debtor continued in possession of its property shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe.

SEC. 191 [11 U. S. C. §594]. A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court.

SEC. 196 [11 U. S. C. §596]. After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the court.

ARTICLE XIII—COMPENSATION AND ALLOWANCES.
[11 U. S. C. §§641-650.]

SEC. 241. The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustees shall not be governed by sections 40 and 48 of this Act.

SEC. 242. The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under this chapter or in connection with a plan approved by the judge, whether or not accepted by creditors and stockholders or finally confirmed by the judge—

(1) by indenture trustees, depositaries, reorganization managers, and committees or representatives of creditors or stockholders;

(2) by any other parties in interest except the Securities and Exchange Commission; and

(3) by the attorneys or agents for any of the foregoing except the Securities and Exchange Commission.

SEC. 243. The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan, or in connection with the administration of the estate. In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto.

SEC. 244. Where a petition is filed under section 127 of this Act, the judge may allow, if not already allowed, reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in the pending bankruptcy proceeding—

(1) by a marshal, receiver, or trustee, as provided in subdivision g of section 48 of this Act, and the attorneys for any of them;

(2) by the attorney for the petitioning creditors;

(3) by the attorney for the bankrupt; and

(4) by any other persons and the attorneys for any of them entitled under this Act to compensation or reimbursement in such bankruptcy proceeding.

SEC. 245. Where a petition is filed in a pending bankruptcy proceeding, the judge may allow reasonable compensation for services rendered and the proper costs and expenses incurred in such bankruptcy proceeding by a referee in bankruptcy. In fixing such compensation, the judge shall not be restricted by the provisions of section 40 of this Act.

SEC. 246. Upon the dismissal of a proceeding under this chapter, or the entry of an order adjudging the debtor a bankrupt, the judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in such proceeding prior to such dismissal or order of adjudication by any persons entitled thereto, as provided in this chapter, and shall make provision for the payment thereof, and for the payment of all proper costs and expenses incurred by officers in such proceedings.

SEC. 247. The judge shall fix a time of hearing for the consideration of applications for allowances, of which hearing notice shall be given to the applicants, the trustee, the debtor, the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate, except that, in the case of allowances for services and reimbursement in a superseded bankruptcy proceeding, notice need be given only to the applicants, the debtor, the trustee, and the unsecured creditors, and may be given to such other classes of creditors or other persons as the judge may designate. In the

case of the dismissal of a proceeding under this chapter and the entry of an order therein directing that bankruptcy be proceeded with, notice of the hearing to consider allowances need not be given to stockholders.

SEC. 248. In the case of the dismissal of a proceeding under this chapter and the entry of an order therein directing that a superseded bankruptcy be proceeded with, the compensation allowed by the judge, in the course of the proceeding under this chapter, to the referee, marshal, receiver, or trustee in the bankruptcy proceeding for services rendered by them in such bankruptcy proceeding shall be deemed to have been allowed in such bankruptcy proceeding, and such compensation shall be considered in connection with the making of future allowances therein or shall be readjusted, so as to comply with the provisions of this Act fixing their compensation in a bankruptcy proceeding.

SEC. 249. Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

SEC. 250. Appeals may be taken in matters of law or fact from orders making or refusing to make allowances of compensation or reimbursement, and may, in the manner and within the time provided for appeals by this Act, be taken to and allowed by the circuit court of appeals independently of other appeals in the proceeding, and shall be summarily heard upon the original papers.

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Supreme Court of the United States

October Term, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

AGAINST

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., et al.,

Respondents.

—o—

IN THE MATTER

OF

NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC.,

Debtor

IN PROCEEDINGS FOR THE REORGANIZATION OF A CORPORATION. TWO CASES (No. 26362 AND No. 27000)

BRIEF FOR RESPONDENT ARNOLD A. WEINSTEIN ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Supreme Court of the United States

OCTOBER TERM, 1962

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Debtor.

IN PROCEEDINGS FOR THE REORGANIZATION OF A CORPORATION, TWO CASES (No. 26362 AND No. 27000)

BRIEF FOR RESPONDENT ARNOLD A. WEINSTEIN ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT—

Preliminary Statement

RESPONDENT WEINSTEIN ADOPTS RESPONDENT FRIED'S BRIEF IN NO. 27000

Weinstein adopts respondent Fried's brief in #26362 as applicable to Weinstein as an officer of the debtor.

The following material is submitted in amplification of Fried's brief and for clarity insofar as his argument applies also to Weinstein.

Question Presented

Does §249 of the Bankruptcy Act, which requires a statement to be filed by applicants for compensation showing any trading in a debtor's stock and denies compensation to those applicants who bought or sold stock during the proceeding, apply to an officer of a debtor in possession whose employment and weekly salary for services to be rendered in the operation of the debtor's business was approved and granted pursuant to §191 of the Bankruptcy Act?

Statement of the Case

Respondent Weinstein was president of Nazareth Fairgrounds & Farmers Market, Inc. before and at the time of the filing of the petition for reorganization. [R9] For the purpose of aiding the reorganization, Weinstein neither asked for nor received any salary. [R10, 17]

On May 19, 1955, acting on a petition by the debtor, the District Court approved the resolution of the debtor's Board of Directors and approved the payment of $50.00 per week to Weinstein, as president, for services to be

rendered. The District Court's approval was given pursuant to § 191 of the Bankruptcy Act. [R23]

Weinstein's duties as president may be summarized as follows: He attended at the market twice weekly during the first year or year and a half after September, 1953 for which he received no compensation. [R449] Thereafter, he went to Nazareth about once a week on the average. [R456] His work consisted of supervising and promoting the market which included establishing merchandising policies and endeavoring to build up a better type of tenancy. [R447-50], and superintending the advertising material put out by the debtor. [R456] Matters involving leases with tenants were passed on by Weinstein. [R485, 488] This statement of Weinstein's services is in general confirmed by the Court of Appeals which also noted that administration of the debtor has been successful. [R574-5]

As in Fried's case, the District Court disassociated Weinstein from management and terminated his compensation "*solely* because he had violated § 249 of the Bankruptcy Act by trading in the debtor's stock" [R249, 257; emphasis by the court] but refused to order recoupment of compensation and expenses "for good and sufficient equitable reasons". [R498]

As for petitioners' charges of misconduct by Weinstein, the Court of Appeals stated:

> "Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which (petitioners) complain; indeed the judge's denial of 'recoupment' would indicate that he did not regard their conduct as having been very iniquitous." [R582]

Petitioners are sometimes referred to as "Wolf" or "Rehrig". Rehrig is a butcher and a tenant of the debtor who purchased stock during the course of the proceeding. [R458] He is the principal petitioner in interest. Philip is one of Rehrig's attorneys [R458] who also purchased stock of the debtor during the course of this proceeding and during the time he was an officer and director of the debtor. [Pet. Br., 8, 9; R227, 575-6, 583]

Summary of Argument

As noted above, Weinstein adopts the argument of Fried to the effect that §249 does not apply to persons receiving a salary for operating the debtor's business. Supplemental points are made as follows:

Before the provisions in §249 may be applied, the judge must fix a time of hearing to consider applications for allowances pursuant to "the necessarily cumbersome procedure of §247". [R579] A host of parties are required to receive notice of the hearing. In the case of Weinstein, more than 394 separate applications would be required, and about 485 applications in the case of Fried, before either of them could receive their weekly salaries. Each application would necessitate ascertainment of the reasonableness of the salaries and benefit to the estate. The burden of such applications on employees, and the court would be enormous. Congress could not have intended such a result.

By its very terms, §247 applies to "applications for allowances". An allowance is granted for the professional and special services already rendered by those persons mentioned in §§241, 242 and 243 who have acted in the proceedings. The granting of an allowance de-

pends upon a showing that the estate received a benefit. Weinstein was not acting in the proceedings. He was engaged in running the debtor's business. His salary therefor was fixed pursuant to §191.

Specific provision is made in §191 for the compensation of officers of a debtor in possession. The purchase of stock by an officer does not bar compensation under §191. To hold that §249 governs an officer's compensation is to render §191 mere surplusage. §249 has never been applied to the compensation of officers of a debtor in possession.

§249 does not mandate the removal of an officer who has purchased stock. The basis for removal is breach of trust. The District Court found no such breach. There is no impropriety inherent in the purchase of stock by an officer. Moreover, in this case, stock was purchased to protect the debtor against a stock raid by Rehrig whose interests are adverse to the debtor. Rehrig has admitted that if he controlled the debtor he would serve his own self-interest by giving himself a preferential lease at the expense of the debtor. Congress did not fashion §249 to disable or discourage an officer from protecting the estate against an adverse interest.

The statements in the Petition for Certiorari and in the Brief for Petitioners charging that Weinstein diverted debtor's rents to himself are false. They were known to be false by counsel for petitioners at the time they were submitted to this court. These statements should be ignored and stricken.

POINT I

§249 does not apply to the salary of an officer of a debtor in possession. Salaries of officers are governed by §191.

Weinstein relies on Fried's brief and on the analysis and reasoning in the opinion of the Court of Appeals to support the view that §249 is not applicable to the salary of an officer. In further support, the following enlargement is offered for consideration by the court:

A. The mechanics involved in the operation of §249 preclude its application to an officer who receives a weekly salary for running debtor's business.

Before the provisions of §249 may be applied, §247 requires the judge to "fix a time of hearing for the consideration of applications for allowances, of which hearing notice shall be given to the applicants, the trustee, the debtor, the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate * * *." Weinstein's salary was approved in May, 1955. [R23] Over seven and a half years have elapsed since that time. This means that more than 394 separate applications to the court would have been required to be made on notice to a host of parties before the judge could come to consider whether under §249 Weinstein was entitled to receive his weekly salary. About 485 applications would have been required in Fried's case.

Congress could hardly have intended that an officer of a debtor whose weekly salary was approved under §191 would be required to make successive weekly applications to the court pursuant to the machinery set up in §247.

The burden on such officer would be too great. He would need a lawyer every week to collect his salary. In turn, the judge would be swamped with such a flood of salary applications as would seriously interfere with the normal functioning of the court. The hearings held on these applications would not be *pro forma* but would entail a review of the services being performed by the applicants to determine whether their salaries were reasonable and whether their services were of benefit to the estate. It is doubtful whether any debtor could impose the burden and expense of such court procedures on a salaried officer and expect to hold him in its employ.

B. The hearings required by §247 apply specifically to "allowances".

It is significant that the opening words of §247 refer to "applications for allowances". The allowances which are contemplated are those in the ordinary and accepted bankruptcy sense for services rendered in the court proceedings. In a Chapter 10 proceeding, an allowance may be granted pursuant to §§241, 242 and 243 to the attorney for the debtor, the referee, trustee, indenture trustees, reorganization managers and the like. The applications for allowances are made at the close of the proceeding and are considered together since the court has a limited fund to distribute which must be apportioned among the applicants entitled. *In re Prudence Bonds Corp.*, 106 F. 2nd 44, CCA 2nd, N. Y. The distinction between an allowance and salary is clear. There is an application under §249 for an allowance for "services (already) rendered". There is an application under §191 for approval of weekly salary payments to be made to an officer for services to be rendered.

The granting of an allowance involves a determination that the services rendered were of benefit to the estate. *Dickinson v. Cowan*, (1940) 309 U. S. 382. No such determination was required in the case of Weinstein as an officer. He was engaged in running debtor's business [R447-51] and his weekly salary therefor was approved by an order made pursuant to §191.

C. §191 specifically provides for the compensation of officers of a debtor in possession.

The pertinent portion of the section reads:

> "A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. * * * *"

This specific provision in §191 makes it abundantly clear that §249 does not govern here. If §249 governed the compensation of officers, §191 would be mere surplusage. "The employment and compensation of officers of the debtor are controlled by §191." 6 Collier on Bankruptcy (14th Ed.) ¶13.04 (2). The compensation to Weinstein was fixed pursuant to §191 [R23]. There is no claim that the order approving Weinstein's salary was obtained by any fraudulent act or concealment or that the District Court mistakenly granted the order.

It is the salary paid for Weinstein's services in the operation of debtor's business which petitioners seek to terminate and recoup because of stock trading which bars compensation under §249. However, §191, which controls the compensation of officers, contains no provision barring compensation to an officer who has purchased stock. Such a purchase invites the scrutiny of the court. Where it is shown that an officer has purchased a debtor's paper for

less than fair or face value his claim therefor will be limited to the actual consideration paid (cf. *In re Los Angeles Lumber Products Co.*, 46 F. S. 77, where a director sought allowance of $252,500 face value of debtor's bonds for which he paid $69,999.84 and the court limited the claim to the director's cost).

§249 has never been applied to the employment and compensation of an officer of a debtor. No case to such effect has been cited by the petitioners or by the District Court below.

POINT II

Neither §249 nor any other section of the Bankruptcy Act mandates the removal of an officer of a debtor for having purchased stock. Such removal may only be based on breach of trust which is absent here.

The order removing Weinstein from participation in debtor's affairs was based *solely* on the claimed violation of §249. [R257; italics by the District Court]

Petitioners have conceded that there is no provision in the Bankruptcy Act which requires the removal of an officer because of trading in the stock of a debtor. [R443] In this context, the only possible justification for removing Weinstein from participation in the debtor's affairs would be conduct amounting to a breach of trust.

It must be stressed that there was no bad faith or breach of trust on the part of Weinstein or Fried. This is confirmed by the District Court which stated that "* * * for good and sufficient equitable reasons they (Weinstein and Fried) will not be compelled to reimburse either compensation or expenses." [R498] There could

be no equities of any kind running in favor of Weinstein if he had been guilty of bad faith or breach of trust. The Court of Appeals took pains to point out that there was no breach of trust by Weinstein. [R582]

Despite the hard words in petitioners' brief, the purchase of stock by an officer is not the signal for calling out the *posse comitatus*. There is no impropriety inherent in such a purchase and it does not involve reflection on personal integrity. *Finn* v. *Childs*, 181 F. 2nd 431, 441; *In re Republic Gas Corporation*, 35 F. Supp. 300, 306. Thus, the vilification of Weinstein in petitioners' brief is wholly indefensible.

In the footnote to Fried's brief on page 25, attention is called to the insincerity of petitioners' attack on Weinstein's and Fried's stock purchases because petitioners themselves raided the debtor's stock. More than insincerity is involved. The protection of the debtor was in issue. The stock raid by Rehrig does not even have the color of a legitimate business investment. The purchase of stock about which petitioners complain was made solely to protect the debtor from control by an adverse interest in the person of Rehrig who was seeking a preferential lease from the debtor with a monopoly in the active meat business at the market. These are the facts:

Rehrig is a butcher and one of debtor's tenants. The sale of meat is one of the most active businesses at the market. [R469] Rehrig wants a preferential lease at the market. All he was willing to pay for his space was $8,000 [R296] despite offers from others of $10,000 and $15,000. [R461] He wants a mopopoly in the sale of meats [R444] which is not in line with the policy of the debtor and is not in its best interests. [R444, 469] He has embarked on a raid of the debtor's stock to gain control

over it for these private purposes. [R296, 444-5, 459-60] It was over Rehrig's strenuous opposition that Weinstein and Fried succeeded in closing a lease with him so that his rental was raised from $6,000 to $15,000 annually. [R458-62]

If Rehrig were in control of the debtor he would serve his own self-interest and the devil take the debtor. Rehrig says so himself: [R445]

> "Q. You just told Mr. Margolis, didn't you, that you felt that $10,000 was plenty for the space that you now occupy? Didn't you say that? A. Yes, sir.
>
> Q. And if you could use that voice on behalf of the Debtor, you would not ask or try to get for yourself any $15,000, would you? A. Not for that spot, no, sir.
>
> Q. In other words, you would prevent that in so far as you were concerned; you would serve your own self-interest, pay only $10,000 despite the fact that you might get $15,000 on behalf of the debtor. Isn't that right? A. Yes, sir."

Weinstein purchased stock for the purpose of preventing Rehrig from getting control and saddling the debtor with the consequences of his self-interest and this was Weinstein's only purpose and reason. [R462-3] There was no solicitation of any stock. [R463] There was no profit or thought of profit by Weinstein. It was only after Rehrig approached stockholders to buy their stock that Weinstein appeared in the picture and in each of those situations Weinstein advised against any sale even to himself. [R303-4, 463]

In the variety of charges made by petitioners, nowhere is it claimed that Weinstein made a single cent of profit

out of the purchase of stock. It is clear that stock was purchased solely to protect the debtor from a stock raid by an interest openly adverse to the debtor in the person of Rehrig. This is the stark and simple fact which emerges from the record.

Rehrig is a butcher and a tenant of the debtor. Wolf is his agent. Wolf is brazenly asking the court to punish Weinstein by way of removal and recoupment of salary for trying to stop his butcher from plucking the debtor. Congress did not fashion §249 to disable or discourage an officer of a debtor from preserving the estate. Such a construction would be a perversion of the statute.

POINT III

The statements by petitioners that Weinstein diverted debtor's rents to himself are false and scandalous. Such statements should be ignored and stricken by the court.

Respondent Arnold A. Weinstein is a member of the Bar of this court.

As a ground for their Petition for Certiorari in #23632, petitioners charged Weinstein with "diversions of debtor's rents to (himself) during the proceedings". [Petition, p. 3] The same charge appears on pages 3 and 50 of the Brief for Petitioners. At the hearings below, counsel for petitioners, stated in open court that he charged Weinstein with grand larceny respecting the so-called rent diversions. [R446]

The foregoing statements are false and counsel for petitioners knew they were false at the time he made them in the Petition for Certiorari and in petitioners' brief. The court is respectfully advised that:

1. the petition for removal [R217-24] does not allege that Weinstein diverted any of debtor's rents to himself;

2. Counsel for petitioners testified at the hearings below and admitted that he had no proof and could produce no evidence indicating that Weinstein received anything with respect to the so-called rent diversions. [R446-7]

Such misstatements contribute nothing to a proper disposition of this appeal. The criminal atmosphere knowingly sought to be created where none in fact exists can only serve to mislead the court. It is of no help to find a grudging admission buried at page 165 of petitioners' 228 page brief to the effect that Weinstein received no part of the alleged diversions. The least the court is entitled to is a fair statement of the facts and this at the very outset.

Of course, it is not known to Weinstein whether the enormity of the grand larceny charge of diverting debtor's assets to himself made against him, an attorney and an officer of the debtor, was instrumental in the original grant of certiorari. It is now urged that the misstatements play no part in the deliberations of the court on the appeal. Such misstatements indicate counsel's lack of confidence in his position and lead to the conclusion that all of his statements respecting the facts as well as the law are not to be taken without verification.* *Falsus in uno, falsus in omnibus.*

The misstatements should be stricken and ignored.

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* Indeed, counsel's resort in his brief to unbridled name calling is by itself enough to arouse suspicion.

CONCLUSION

The decision of the Court of Appeals should be affirmed.

Dated: New York, N. Y.,
January 15, 1963.

Respectfully submitted,

ARNOLD A. WEINSTEIN,
Counsel pro se.

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Supreme Court of the United States

October Term, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*

In the Matter
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

BRIEF FOR RESPONDENT WILLIAM McK. SHONGUT

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

In Proceedings for the Reorganization of a Corporation (No. 27000)

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In Proceedings for the Reorganization of a Corporation (No. 27000)

This is an appeal from a judgment of the Court of Appeals for the Second Circuit which "reversed the order in No. 27000 except as specified in this opinion. * * * On the petitions to review the order of the Referee in Bankruptcy,

the district court is directed to modify the order of October 5, 1957, in accordance with this opinion." (*In re Wolf, et al.* v. *Nazareth, etc.*, 296 F. 2d 670, 675.)

Respondent, William McK. Shongut (one of the "Margolis group") purchased 10 shares of Nazareth stock for which he paid $10,000.00 pursuant to a written agreement.

Under "bar orders" issued by the District Court, 41 stock claims were filed, including the five "Margolis" claims, all of which were referred to John E. Joyce, Referee in Bankruptcy, to hear and determine. In 1957, Referee Joyce tried the five stock-claims of the "Margolis group" alone. In a decision dated August 30, 1957, the Referee held that "(1) The issuance of stock other than to Zoloth and Soble (original issue of 20 shares) was void. (2) None of the claimants acquired any stock which had been validly issued to Malakoff. (4) An order should be entered disallowing the claim(s) of * * * William McK. Shongut, * * *. (6) No equity exists in favor of any of the claimants against the debtor." Upon the entry of the order disallowing the Shongut claim, a Petition for Review was promptly filed and submitted before District Judge Sugarman. The District Court never passed on this petition. Judge Sugarman then revoked the general reference to Referee Joyce with respect to the remaining 36 stock claims and undertook the trial thereof. The District Court, by order of December 8th, 1960, allowed all 36 claimants to participate in the estate according to the "net fair value of their respective investments." This order did not include nor dispose of the Shongut claim, then pending on review.

The judgment of the Court of Appeals made and entered on November 9, 1961, modified the order of the District Court and allowed 32 claims, confined to "those investors who paid for a participation in the Nazareth market by cash, check or credit" and limited "the allowed claims in terms of dollars rather than in invalidly issued shares."

The Court of Appeals then by-passed the District Judge and considered the rights of the Margolis group, holding:

Judge Moore:

> "Another group (the Margolis group) involved in a separate appeal (No. 26962) must be considered as potential participants. The Referee in Bankruptcy found no equity in favor of any claimant in this group, i.e., * * * William McK. Shongut (10 shares).
>
> "Despite the fact that the Margolis appeal relates directly only to the district court's order permitting a reopening of the proceedings as to this group, there is sufficient proof before this court to enable us to indicate our views as to the rights of these claimants (296 F. 2d 670, 676).

* * *

William McK. Shongut:

> "William McK. Shongut's 10 shares were acquired pursuant to an alleged agreement with Margolis whereby he delivered to Margolis, as attorney, his check for $10,000. Margolis deposited this check in his bank account and Margolis guaranteed Shongut an income on the stock of 20% a year for 6 years. Shongut actually had given this $10,000. to Margolis for investment in Nazareth. However, Margolis only gave by checks and cash $6,287.34 to Malakoff. Shongut, therefore, should be allowed $6,287.34; for the rest he must look to Margolis (296 F. 2d 674, 677)."

In the instant appeal the petitioners do not question the allowance of Shongut's claim. They seek a modification of the District Court's order of December 8, 1960 to the extent that each of the 36 stock-claimants be the owners of the stock arithmetically reduced in proportion, for a total authorized issue of 200 shares. A judgment on this basis will leave the Shongut claim undetermined.

Shongut actually paid $10,000 for 10 shares of Nazareth stock, pursuant to a written agreement, so that his claim must be allowed, either under the "net fair value" theory of the Examiner and adopted by the District Judge, or under the equitable principle adopted by the Court of Appeals. Shongut's purchase money reached Malakoff so that his rights are at least equal to, if not superior to, the 36 allowed claims.

The dollars actually paid to Malakoff as set forth in the findings of the Examiner and the trial court were gross sums paid by the individual investors, and included commissions paid. Shongut actually paid $10,000 for his ten shares. Margolis deducted his commission of $2,000* in his accounting with Malakoff. Shongut, therefore, should be allowed $8,287.34.

CONCLUSION

Respondent Shongut respectfully submits that if the "net fair value" theory of the District Court is affirmed he should be allowed the equivalent of his purchase in valid stock. If the "equitable principle" of the Court of Appeals is affirmed, the Shongut dollar allowance should be increased to $8,287.34.

Respectfully submitted,

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---

* Finding 8, Referee in Bankruptcy John E. Joyce, August 30th, 1957.

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ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., et al.,
Respondents.

—o—

IN THE MATTER

OF

NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC.,
Debtor.

IN PROCEEDINGS FOR THE REORGANIZATION OF A CORPORATION, TWO CASES (No. 26362 AND No. 27000)

Brief for Respondent Nazareth Fair Grounds & Farmers' Market, Inc., Debtor and Debtor in Possession on Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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Supreme Court of the United States

OCTOBER TERM, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

AGAINST

ARNOLD A. WENSTEIN, JEROME FRIED, NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., et al.,

Respondents.

IN THE MATTER

OF

NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC.,

Debtor.

IN PROCEEDINGS FOR THE REORGANIZATION OF A CORPORATION, TWO CASES (No. 26362 AND No. 27000)

Brief for Respondent Nazareth Fair Grounds & Farmers' Market, Inc., Debtor and Debtor in Possession on Writ of Certiorari to the United States Court of Appeals for the Second Circuit

CASE ONE

No. 27000

Statutes Cited

The pertinent text of the constitutional provision and statutes is set forth in Appendix B.

Questions Presented

Where there are two categories of stock claimants in a bankruptcy proceeding, to wit:

A. Investors—those who were solicited by a fraudulent promoter to invest, and paid present considerations for participation in, a specific venture, no part of which was paid for or owned in fact or in equity by said promoter;

B. Non-Investors—those who received interests in said venture from the promoter in satisfaction of, or security for his unrelated personal obligations to them, and

where the amount invested in the venture and paid to the promoter by investors was greatly in excess of the amount required for the venture, including the cost of acquisition of the subject property.

1. Did the Court of Appeals properly determine that the investors are entitled to share in the bankrupt estate in proportion to their investments, and that non-investors, who received their interests in satisfaction of the promotor's personal obligations, are not entitled to share?

2. In the allowance or disallowance of claims of stock interests in a reorganization proceeding, does a Court of Bankruptcy in the exercise of its powers have jurisdiction to ascertain and enforce the equities of parties before it and apply its own equitable principles according to the circumstances of the particular case? The corollary to this is the proposition whether the bankrupty court in the distribution of property in its possession has full jurisdiction to determine the rights of parties in and to that property.

Statement of the Case

The Debtor operates a farmers' market and shopping center in Nazareth, Pa. The events leading up to the acquisition of the market and the dealings relating to participations therein are hereinafter set forth. The function and role of one John Malakoff, as the promoter or syndicator of the Nazareth venture which became the Debtor, is of prime importance.

Murray Realty Co. was a Pennsylvania partnership composed of Edward Malakoff and Murray Malakoff. Zoloth and Soble were joint venturers or dummies in certain of the real estate transactions in which Murray engaged [R. 230-1, 286-7].

To avoid personal liability, Murray would take title to real property in the name of Richard Realty Co. or Kipling Realty Co., Pennsylvania corporations, the stock of which was wholly owned by Murray [R. 282-3]. These persons or entities are sometimes referred to as the Philadelphia Group.

On April 17, 1951, Richard Realty Co. closed title and purchased the realty and business now owned by the Debtor from Nazareth Fairgrounds, Inc., a corporation unrelated to the Debtor. The title closing statement [R. 531] shows the purchase price to have been $66,000, subject to two mortgages totalling $18,500.* The actual cash payment required of Richard Realty was $47,500. It was this cash amount which was involved when John Malakoff purchased the business and property in the manner hereinafter set forth.

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*On May 14, 1951, Richard conveyed the business and realty to Kipling Realty Co. (a dummy corporation) subject to the two mortgages [R. 230-31]. On September 26, 1951, Kipling conveyed to the Debtor [R. 231].

The purchase transaction was reflected in the journal of Murray Realty Co. [R. 537]. The journal reflects the payment of $42,732.99 to Commercial Title Co. in accordance with the closing statement. Disregarding some minor entries which are immaterial, the $5,000. (reflected on the closing statement as having been paid on account) appears in the journal under date of May 7, 1951 as having been paid by E. Malakoff.

In April of 1951 when the Philadelphia Group first acquired the Nazareth property, John Malakoff and Edward Malakoff, his nephew and head of the Philadelphia Group, met with claimant, Kanter, and others. Edward Malakoff proposed to them that they buy one-fourth of the Nazareth market for $16,000. Kanter and the others agreed to do so and advanced the necessary funds. None of John Malakoff's money was used to pay the purchase price. His interest was contingent. He was to receive a share of the profits in the event of a sale [R. 306-7]. John Malakoff's record book showed his interest as "one-third of profit to office" [Saul, General: Debtor's Ex. K—R. 547].

Edward Malakoff denied any arrangement to sell a one-fourth interest in the market. Instead, he described an oral agreement of July 1951 whereby John Malakoff agreed to purchase the Nazareth business and real estate at the price paid for it by the Philadelphia Group, namely, $47,500. (cash) plus $30,000., plus $2,800. which covered miscellaneous items [R. 283].

The Philadelphia Group organized the Debtor on or about August 1st, 1951. Its office was designated as Room 603, 1660 Walnut Street, Philadelphia which was the office of Murray Realty Co. [R. 53]. The Debtor was authorized to issue 200 shares of no par value stock with a stated capital applicable thereto of $120,000.

On August 8, 1951, Debtor's stock certificate No. 1 was issued to Zoloth and Certificate No. 2 was issued to Soble, each certificate being for ten shares.

On October 17, 1951, Zoloth and Soble assigned their 20 shares of stock to John Malakoff pursuant to a contract of sale [Saul, General: Debtor's Ex. F—R. 540-41]. The price was $32,853.08 payable in installments and the contract provided that the certificates were to be held in escrow by the sellers who retained the voting rights until payment was made.

Simultaneously with the formation and incorporation of the Debtor, the Philadelphia Group converted their capital contributions in the Nazareth venture to loan accounts. Thus, Soble's books were adjusted to transfer John Malakoff's capital account of $17,489.00 * to a loan account; similarly, Soble's capital account of $40,000 was transferred to a loan account of $37,000, and, after minor adjustments, the balance of $1,500 remaining as capital of Zoloth [Saul, General: Examiner's Ex. BU—R. 507].

The next step was to transfer these capital and loan accounts on the books of the Debtor. This was done [R. 439-40]. Originally, the loans were capital investment. No money was actually put in at the time of the loan entries—they were mere book entries [R. 433-4].

The procedures used by the Philadelphia Group and Malakoff constituted a design whereby public investors were to be bilked.

During the course of the foregoing transactions, John Malakoff solicited and received funds from claimants who gave him their money for the express purpose of investing

* This was not Malakoff's money. It was supplied by investors specifically for Nazareth.

in Nazareth. Appendix 'A' is a schedule showing the amounts of money received by Malakoff from Nazareth investors and the amounts he, in turn, paid to the Philadelphia Group. At all times, Malakoff received more from the investors in Nazareth than he paid out:

A. Up to February 15, 1952 (the date of the last payment to the Philadelphia Group) Malakoff received a total of $88,025. for investment in Nazareth;

B. Up to February 15, 1952, Malakoff paid $49,489 to the Philadelphia Group. He also paid $9,507.00 for improvements to the Nazareth property. In all, Malakoff paid out $58,996;

C. Up to February 15, 1952, Malakoff received $29,029. more from the investors than he paid to the Philadelphia Group and for improvements;

D. After February 15, 1952, Malakoff received an additional $72,337. for investment in Nazareth;

E. After February 15, 1952, there were no further payments to the Philadelphia Group;

F. All told, Malakoff received $160,362. and paid out $58,996., the excess of his receipts over payments amounting to $101,366.

Malakoff assumed control of the Debtor before October, 1951. No corporate meetings were held. The minutes reflected in the minute book were back dated [=32—R. 56].

With some exceptions, investors paid $1000.00 per share or participation based on 200 shares to be issued and a representation that dividends of 20% annually would be

paid on the amount invested [=127—R. 204]. The Nazareth project was a joint venture [=38—R. 208]. At the outset, title was in the Debtor corporation but subject to change in the future to a limited partnership [R. 187]. All checks given for investment in Nazareth were drawn to John Malakoff or his agent and were endorsed "John Malakoff, agent" or "John Malakoff, special". All cash given for investment was delivered to Malakoff.

So-called dividend payments made by Malakoff during the course of his promotion were in fact a return of capital to the recipients. No dividends were ever declared by the Debtor. It had no profits or surplus out of which any dividends could be declared.

Beginning in February, 1953 and thereafter, Malakoff issued stock certificates to the investors and also issued stock certificates in satisfaction of, or as security for, his personal obligations. In all, 316 shares were issued despite authorization for only 200.

Late in May or June of 1953, Malakoff caused the preparation of a set of predated minutes which purported to have all of the Debtor's stock issued to him. The Court of Appeals has found these minutes to be fraudulent [R. 592].*

In June, 1953, Malakoff's fraudulent promotion came to an end. On June 17, 1953, he assigned stock certificates No. 1 and No. 2 to the Debtor by endorsement [=37—R. 57]. He also released the so-called loan accounts owing to him on the books of the Debtor and described the same as having been owed to him for services rendered [R. 554-6].

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* These were not the only Nazareth minutes found to be fraudulent *Margolis* v. *Nazareth Fairgrounds & Farmers Market, Inc.*, Debtor, 240 F. 2d 221 (1957).

The end of the promotion found the Debtor in difficulty with respect to the ownership of its shares of stock. The Debtor was insolvent in the bankruptcy sense [Bankruptcy Act, Section 1(19)] and under Chapter 10 of the Act [Section 130(1)] from the time of its incorporation to the time of the filing of the petition. On August 8, 1951, current liabilities exceeded current assets with net worth of only $1,500 [R. 513]. On June 30, 1952, liabilities exceeded assets [R. 514]. At June 30, 1953, judgment notes for $13,600, which were unreflected on the balance sheet for that date, resulted in current liabilities greater than current assets [R. 518; judgments vacated in 1957—*Margolis v. Nazareth Fairgrounds & Farmers Market, Inc.*, 249 F. 2d 221]. The Debtor was also insolvent under the laws of Pennsylvania.* Shortly before the petition was filed, the Debtor could not pay its bills as they matured [R. 400].

On September 28, 1953, a petition for reorganization under Chapter X of the Bankruptcy Act was submitted to the U. S. District Court for the Southern District of New York and the process of reorganization has been going on since that time.

Summary of Argument

A court of bankruptcy is a court of equity and, in allowing and disallowing claims and distributing the assets of the bankrupt estate, it is empowered to apply its own equitable principles. Its application of state law is discretionary. In any case, petitioners have not cited any controlling state equitable principles which are properly applicable here. Whatever state authorities do exist

* *Fidelity Trust Co. v. Union National Bank of Pittsburgh*, 315 Pa. 467, 480.

are not in conflict with the equitable principles applied by the Court of Appeals below.

John Malakoff did not own any interest in the Nazareth venture. He made no contribution to the venture. He was a fraudulent promoter who solicited funds of others for investment. In the process, he collected $160,362. from the investors and paid out of these funds only $58,996. for venture purposes [Appendix A]. Additionally, he satisfied his personal obligations to the extent of more than $62,000. by giving out shares of Nazareth to his creditors. This was done at a time when the Debtor was insolvent.

Malakoff and the Philadelphia Group deceitfully conceived, created and used the debtor corporation to effectuate a fraud on the Debtor's existing and future creditors and stockholders. This was done through the use of a fictitious loan account and other fraudulent devices, all of which rendered Debtor insolvent.

Despite these frauds, petitioners contend that the initial 20 shares of stock issued by the Debtor and held by Malakoff, as well as a loan account on Debtor's books in his name, are valid and that Malakoff was thereby the owner of all the Debtor's stock, both issued and unissued. Thus, petitioners' claims are predicated on muniments of title fraudulently acquired by Malakoff.

In the light of the frauds practiced, and because the Debtor corporation was merely a transitory vehicle for the Nazareth venture, equity dictates that its corporate veil be pierced and a trust impressed on its assets for the benefit of the investors in proportion to the contributions they actually made to the venture. The Debtor, which was the *alter ego* of Malakoff [=133 B. 206], was fraudulently created in violation of Malakoff's

fiduciary obligations to the investors. A court of equity should, therefore, look to the substance of the transaction by disregarding the corporate entity.

Petitioners submit their arguments based on the application of strict corporate law. This would work an inequitable result. Moreover, the corporate law cited by petitioners does not apply here.

Only the investors who contributed specifically to the Nazareth venture are entitled to share in the distribution of the assets of the bankrupt estate. Claimants who received their interests in the venture in satisfaction of the promoter's personal obligations, and who therefore contributed nothing to the venture, are not entitled to share in the distribution of the bankrupt estate.

POINT I

A Bankruptcy Court is a Court of equity and in the exercise of its powers has jurisdiction to ascertain and enforce the equities of parties before it and apply its own equitable principles according to the circumstance of the particular case. As a corollary to this is the proposition that the Bankruptcy Court in the distribution of property in its possession has full jurisdiction to determine the rights of parties in and to that property.

The petitioners have raised the issue of the scope and extent of the powers of a Court of Bankruptcy. They question the Court's right to apply its own equitable substantive law and principles. They maintain that a Federal Court, in the instance of bankruptcy, must apply the state law of the forum. It is necessary, therefore, to trace the development of the powers of Courts of Bankruptcy under the Congressional enabling statutes which

put Article 1, Section 8, Clause four of the United States Constitution into effect, and to the decisions of this Court which have discussed, interpreted and amplified the extent of the equitable powers of a Court of Bankruptcy.

Article 1, Section 8, Clause four of the Constitution of the United States gives to Congress the power "To establish * * * uniform Laws on the subject of Bankruptcies throughout the United States;"

Our original thirteen states were, of course, former English Colonies. They brought England's bankruptcy laws with them as they did the Common Law upon which our legal institutions are based.

There was no uniform pattern followed by the states in the regulation of commercial transactions and of insolvencies. This impeded interstate commercial practice.

In England, bankruptcy laws were enacted as an adjunct and aid to their laws governing commerce.

Madison commented at that time:

> "The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce and will prevent so many frauds where the parties or their property may lie or be removed into the different states, that the expediency of it seems not likely to be drawn into question." The Federalist No. 42; and see Senate Doc. No. 65, 72nd Congress, 1st sess. (1932) 50.

Charles Pickney, author of the first draft of the bankruptcy clause and his fellow delegates who attended the Constitutional Convention, did not however include the bankruptcy provision in Clause Three which was partly

restrictive and related to Commerce. Instead, Article I, Section 8, Clause four of the Constitution was enacted. These circumstances, and a reading of Article I, Section 8, *supra*, clearly supports an inference that it was the intention of the draftsmen to give Congress the all inclusive power to legislate and implement on all issues involving the subject of bankruptcies.

It is beyond question that the granting of the all inclusive power of legislation in bankruptcies necessitates the all inclusive power of implementation thereof, otherwise the result would be a nullity.

The following provisions of the Bankruptcy Act were enacted by Congress which affect the issue which is before the Court: (The text of these statutes is to be found in Appendix B.)

Section 2 of the Bankruptcy Act, 11 U. S. C. §11; Section 67b of the Bankruptcy Act, 11 U. S. C. §107b; Section 67c of the Bankruptcy Act, 11 U. S. C. §107c; Section 67f of the Bankruptcy Act, 11 U. S. C. §107f; Section 70a of the Bankruptcy Act, 11 U. S. C. §110a; Section 70c of the Bankruptcy Act, 11 U. S. C. §110c; Chapter X, Section 111 of the Bankruptcy Act, 11 U. S. C. §511. Chapter X, Section 112 of the Bankruptcy Act, 11 U. S. C. §512; and Chapter X, Section 196 of the Bankruptcy Act, 11 U. S. C. §596.*

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* §196 of the Bankruptcy Act gives the bankruptcy court power to determine "the interests of stockholders" Petitioners do not claim that Chapter X is unconstitutional, nor could they in view of *Continental Bank* v. *Rock Island Railway* (1935) 294 U. S. 648. As stated in Collier on Bankruptcy (14 Ed.) Vol. 6, p. 95:

> "A corporate reorganization statute represents an exercise of the power conferred on Congress by Article 1, §8, Clause 4 of the Constitution, 'to establish * * * uniform laws on the subject of bankruptcies throughout the United States'. The charge that such a statute is not within the 'subject of bankruptcies' has been refuted many times by the courts."

These sections, of course, are only several of the sections affecting the question before this Court but will suffice, since they are amply illustrative for the purpose of the discussions.

The question to be answered therefore is:

> "Does a Court of Bankruptcy within the purport and spirit of the Bankruptcy Act when dealing with the allowance, disallowance and subordination of claims, and the distribution of a bankrupt's estate, have the power to apply its own equitable principles and implement the decision?"

It is to be noted that under Section 2b of the Bankruptcy Act, 11 U. S. C. §11b, *the purport of the Act was to give bankruptcy courts inherent and general powers that a Court of equity has which have not been specifically enumerated.* This provision obviously was not intended to restrict the powers of a bankruptcy court as a court of equity, but rather, was obviously intended to grant such Court the broadest possible equity powers.

Under Section 67b of the Bankruptcy Act, 11 U. S. C. §107b, Congress specifically provided which laws of a state (statutory lien laws) should be binding, showing an intention under the Bankruptcy Act to provide specifically when a Federal Court must recognize State law. Thereafter, by sections 67c(1) and (2), 11 U. S. C. §107c (1) and (2), even that recognition was restricted. If Congress intended that a Federal Court of Bankruptcy must apply state law in all instances, then Section 67b, *supra*, would be superfluous and unnecessary because that principle would be all embracing.

The Rules of Decisions Act (28 U. S. C., Sec. 1652; 62 Stat. 1652), upon which petitioners rely as authority for

the application of state laws here, does not apply in bankruptcy. The Act contains an express proviso that the laws of the several states apply "except where the Constitution * * * or Acts of Congress otherwise require or provide." Proceedings in Bankruptcy fit within the exception. Congress has enacted the Bankruptcy Act pursuant to the Constitutional grant of power to enact uniform bankruptcy laws. *Local Loan Co.* v. *Hunt*, 292 U. S. 234, 240 (1934).

The general proposition that a Bankruptcy Court is a Court of equity is well established. In the exercise of its powers as such, it has the jurisdiction to ascertain and enforce the equities of parties before it. Corollary to this is a proposition that the Bankruptcy Court in the distribution of property in its possession, has full jurisdiction to determine the rights of parties in and to that property.

Subsection (7) of 2 of the Bankruptcy Act of 1898, as amended, provides that courts of bankruptcy are invested with such jurisdiction at law and in equity as will enable them to "cause the assets of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided."

The trend to retain and exercise exclusive powers in bankruptcy in the Federal Courts was enunciated in the early case of *Sturges* v. *Crowninshield*, 4 Wheat. 122 (1819). Chief Justice Marshall declared that the power to legislate in the bankruptcy field was available to the states unless and until the Federal Government exercised the power.

"It is not the mere existence of the power, but its exercise, which is incompatible with the exercise of

> the same power by the States. It is not the right to establish these uniform laws, but their actual establishment, which is inconsistent with the partial acts of the States."

In examining the history of this doctrine, it is well to remember that during the greater part of the history of our country there was no federal bankruptcy law in effect. The states themselves, however, generally made use of their legislative powers in this field during the first one hundred years of our existence as a republic. The sporadic exercise of the federal bankruptcy powers in the periods from 1800 to 1803, 1841 to 1843, 1867 to 1878, and then from 1898 to the present day gave rise to litigation involving the question of the suspension of state law by reason of the enactment and operation of these federal bankruptcy acts. From these cases, the doctrine has come to be well settled "that state insolvency laws which are tantamount to bankruptcy because they provide for an administration of the debtor's assets and a winding up of his affairs similar to that provided by the national act are suspended while the latter remains in force, and proceedings under them are utterly null and void whether commenced within four months of the filing of a petition in bankruptcy or before. *Straton* v. *New*, 283 U. S. 318, 327 (1931).

Hollins v. *Brierfield Coal & Iron Co.*, 150 U. S. 371 (1893) was a forerunner of the cases involving bankruptcy principles and the powers of a bankruptcy Court.

The Court held (p. 379):

> "The line of demarcation between equitable and legal remedies in the Federal Courts cannot be obliterated by state legislation."

and on page 382:

> "When a corporation becomes insolvent, it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors. A court of equity, at the instance of the proper parties, will then make those funds trust funds, which, in other circumstances, are as much the absolute property of the corporation as any man's property is his."

Scott v. *Neely*, 140 U. S. 106 (1891) held: The general proposition that new equitable rights created by the States may be enforced in the Federal Court is correct but it is subject to the qualification that such enforcement does not impair any right conferred, or conflict with any prohibition imposed by the Constitution or Laws of the United States.

In *Bardes* v. *Hawarden Bank*, 178 U. S. 524 (1900), it was held that proceedings in bankruptcy being in the nature of proceedings in equity, frequently call for the exercise of the full equity powers of the Court in the ascertainment and proper enforcement of the equities of the parties, and that where this is so a court may apply equitable rules and will be governed by equitable principles. This case was followed shortly by the case of *Mueller* v. *Nugent*, 184 U. S. 1 (1902) holding that the filing of the petition in bankruptcy is in effect an attachment and upon adjudication the title vests in the trustee and the custody of the property vests in the bankruptcy court.

Thhereafter, in the case of *Whitney* v. *Wenman*, 198 U. S. 539, 552 (1905), it was held that by virtue of the powers granted under subsection (7) of Section 2 of the Bankruptcy Act, there is vested in the bankruptcy court com-

plete jurisdiction to determine controversies in relation to the property in the court's control, and to proceed to a complete determination of a matter of controversy.

In *Kothe Trustee* v. *R. C. Taylor Trust*, 280 U. S. 224 (1930), this Court did not apply state law and held at page 227,

> "The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands based upon adequate considerations."

Since the decision in *Kothe Trustee* v. *R. C. Taylor Trust*, there have been a number of decisions both in the Supreme Court and in other federal courts holding that where a court of bankruptcy has once assumed control of the bankrupt's property, it has exclusive jurisdiction to determine all questions affecting that property. *Isaac* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734 (1931); *Gross* v. *Irving Trust Co.*, 289 U. S. 342 (1931); *Taylor* v. *Sternberg*, 293 U. S. 470 (1935).

The case of *Local Loan Co.* v. *Hunt*, 292 U. S. 234 (1934) is particularly significant. There the Court held at page 240:

> "* * * courts of bankruptcy are essentially courts of equity and their proceedings inherently proceedings in equity * * *."

at page 244:

> "We find it unnecessary to consider whether this contention would in a different case find support in §34 of the Judiciary Act of 1789, now §725, Title 28, U. S. C. since we are of opinion that it is precluded here by the clear and unmistakable policy

> of the bankruptcy act. It is important to bear in mind that the present case is one not within the jurisdiction of a state court, but is a dependent suit brought to vindicate decrees of a federal court of bankruptcy entered in the exercise of a jurisdiction essentially federal and exclusive in character. And it is that situation to which we address ourselves, and to which our decision is confined."

It is significant that the Bankruptcy Court is created under the authority of the Constitution and in allowing, disallowing or subordinating claims is acting under a Congressional Act.

The case of *Kuehner* v. *Irving Trust Co.*, 299 U. S. 450 (1936), was a 77B Reorganization case and involved a claim of bankruptcy for damages for breach of contract under a lease between the bankrupt and the claimant.

The claimant raised the issue that the bankruptcy act as applied to him exceeded the legislative powers granted and infringed upon personal *guarantees* given by the Constitution, and that the resulting violations of the Constitution were transgressions of the boundaries of the bankruptcy power vested in Congress and the taking of their property without due process.

The Court held that the equitable distribution of a bankrupt's assets or the equitable adjustment of creditors' claims in respect to their assets by way of reorganization may thereafter be regulated by a bankruptcy law which impairs the obligations of the debtor's contracts. *Indeed, every bankruptcy act avowedly works such impairment.*

A non bankruptcy case *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938) appeared on the horizon and seemed to becloud the issue and the trend until *Pepper* v. *Litton*, 308 U. S. 295 (1939), a bankruptcy case, was decided by

this Court one year later. This court reinstated the trend and vigorously supported the equity powers of a bankruptcy court in the allowance, disallowance or subordination of claims in a bankruptcy case.

The *Erie* case involved a tort action and this court held that in a non-diversity case *except in matters governed by the Federal Constitution or by Acts of Congress* the law to be applied in any case is the law of the State and that there is no Federal, general common law.

In *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307 (1939), this Court again decided that the power of the Bankruptcy Court to subordinate or to adjudicate the equities between the several creditors is complete.

The *Erie* case was then distinguished and held inapplicable to bankruptcy cases by *Pepper* v. *Litton*, 308 U. S. 295 (1939) which involved a bankruptcy proceeding. The Court stated at page 303:

> "Courts of bankruptcy are constituted by 1 and 2 of the Bankruptcy Act (30 Sat 544) and by the latter section are invested 'with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings. Consequently, this Court has held that for many purposes 'courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity' *Local Loan Co.* v. *Hunt*, 292 U. S. 234, 240. By virtue of 2 a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the Act, it applies the principles and rules of equity jurisprudence. *Larson* v. *First State Bank*, 21 F. 2d 936, 938. Among the granted powers are the allowance and disallowance of

> claims; the collection and distribution of the estates of bankrupts and the determination of controversies in relation thereto; the rejection in whole or in part—'according to the equities of the case' of claims previously allowed, and the entering of such judgments 'as may be necessary for the enforcement of the provisions' of the Act. In such respects the jurisdiction of the bankruptcy court is exclusive of all other courts. *United States Fidelity & Guaranty Co.* v. *Bray*, 225 U. S. 205, 217."

Sampsell v. *Imperial Paper & Color Corp.*, 313 U. S. 215, 219 (1941), decided by this Court reiterated the principle laid down in the *Standard Gas* case, *supra*, and held that,

> "The power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several creditors is complete."

This was followed by *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89 in 1942 where this Court held that nothing decided in *Erie R. Co.* v. *Tompkins* requires a court of bankruptcy to apply a local rule governing the liquidation of insolvent estates. The bankruptcy act prescribes its own criteria for distribution to creditors.

In *American Surety Co.* v. *Sampsell* (1946), 327 U. S. 269, the Court said at page 272:

> "We recently had occasion to reiterate that federal bankruptcy law, not state law, governs the distribution of a bankrupt's assets to his creditors. *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, 95. See also *Pepper* v. *Litton*, 308 U. S. 295, 303-306; *Prudence Realization Corp* v. *Ferris*, 323 U. S.

650, 653. True, we stated in both *Prudence* opinions that the federal law governing distribution of a bankrupt's estate should be applied with 'appropriate regard for rights acquired under rules of state law * * *.' *But the extent to which state law is to be so considered is in the last analysis a matter of federal law.*" (Emphasis added.)

Heiser v. *Woodruff*, 327 U. S. 726 (1946) is important in the line of cases which clarified the powers of a bankruptcy court. This court stated at page 731:

> "We need not consider whether, apart from the requirements of the full faith and credit clause of the Constitution, the rule of *res judicata* applied in the federal courts, in diversity of citizenship cases, under the doctrine of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64; cf. *Guaranty Trust Co.* v. *York*, 326 U. S. 99; *Holmberg* v. *Armbrecht*, 327 U. S. 392, can be other than that of the state in which the federal court sits. For nothing decided in *Erie R. Co.* v. *Tompkins*, *supra*, requires a court of bankruptcy, in applying the statutes of the United States governing the liquidation of bankrupts' estates, to adopt local rules of law in determining what claims are payable, or to be allowed, or how the bankrupt's estate is to be distributed among claimants. Cf. *Board of Comm'rs* v. *United States*, 308 U. S. 343; *Deitrick* v. *Greaney*, 309 U. S. 190; *D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447; *Helvering* v. *Stuart*, 317 U. S. 154, 161-2; *Sola Electric Co.* v. *Jefferson Co.*, 317 U. S. 173, 176; *Wraaq* v. *Federal Land Bank*, 317 U. S. 325, 328; *Clearfield Trust Co.* v. *United States*, 318 U. S. 363."

Vanston Committee v. *Green*, 329 U. S. 156 (1946) is a landmark case in establishing this court's recognition of the difference between *Erie* v. *Tompkins*, *supra*, and a bankruptcy case in applying state law or Federal law whether statutory or by court decision. The Court stated at pages 162 and 163:

> "In determining what claims are allowable and how a debtor's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits. *Erie R. R.* v. *Tompkins*, 304 U. S. 64, has no such implication. That case decided that a federal district court acquiring jurisdiction because of diversity of citizenship should adjudicate controversies as if it were only another state court. See *Holmberg* v. *Armbrecht*, 327 U. S. 392. But bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles."

In *Gardner* v. *New Jersey*, 329 U. S. 565, 573 (1947) (a bankruptcy reorganization case), a state claimed that by its state created statute it had a claim which had to be recognized. The court held:

> "• • • Without that sifting process, unmeritorious or excessive claims might dilute the participation of the legitimate claimants.
>
> "It is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure. *Wiswall* v. *Campbell*, 93 U. S. 347, 351. If the claimant is a State, the procedure of proof and allowance is not transmuted into a suit against the

> State because the Court entertains objections to the claim. The State is seeking something from the debtor. No judgment is sought against the State. The whole process of proof, allowance and distribution is, shortly speaking, an adjudication of interests claimed in a *res*. It is none the less such because the claim is rejected *in toto*, reduced in part, given a priority inferior to that claimed, or satisfied in some way other than payment in cash. * * * "

The administration and distribution of the property of bankrupts is a proceeding in equity. The jurisdiction to inquire and determine who the lawful owners are, and to that end to call before it all claimants by a reasonable notice, and order them to present their claims to the court within a reasonable time, or to be barred of any right or interest in the property in its custody or in its proceeds, is a power inherent in every court of equity, incidental and indispensable to the authority to administer the property in its possession and to distribute its proceeds. *Nisbet* v. *Federal Title & Trust Co.* (C. C. A. 8th Cir.), 239 Fed. 644, cert. den. 241 U. S. 669. And since a bankruptcy court is one of equitable jurisdiction, it is not bound to apply local rules of state law in determining and fixing the relative rights of creditors in the distribution, or in determining the provability and allowability of claims.

> *In re Commonwealth Light & Power Co.* (7 C. A. 1944), 141 F. 2d 734 cert. den. 322 U. S. 766;
> *Farmers State Bank* (1945), 300 Ky. 201, 187 S. W. 2d 793;
> *In re V-I-D Inc.* (7 C. A. 1952), 198 F. 2d 392 cert. den. 344 U. S. 914;
> 1 Collier on Bankruptcy (14th ed.), 168, 169.

Whether creditor claims or stock claims or interests are being determined, the same reasoning may be applied to claims to an interest in a venture or to the capital stock of a corporation which the reorganization court is to determine under §196 of the Bankruptcy Act.

Petitioners' position is unsound. They have not even cited Pennsylvania or New York law of equity as authority for the position they have taken in this case. Instead, they seek an artificial application of technical state corporate law not applicable to the facts in this case and in disregard of the fact that this proceeding is one in bankruptcy.

The Court of Appeals allowed the claims of those claimants who actually invested and contributed in the Nazareth business and real estate. It disallowed the claims of those claimants who acquired their interests from a fraudulent promoter in satisfaction of his personal debts and obligations. The Court's determination was equitable and the Court of Appeals had the jurisdiction and power under the Constitution, Bankruptcy Acts and the cases herein cited to do so.

POINT II

Malakoff did not own the Nazareth venture, the realty nor the capital stock of the Debtor.

Petitioners' fundamental position is based on the premise that Malakoff owned the venture, realty or capital stock of the Debtor. Thus, petitioners' brief (p. 92) "Malakoff himself paid the Philadelphia group $60,000. for the market"; (p. 113): "On July of 1951, Malakoff contracted with the Philadelphia group to buy—and he then acquired an *equitable* interest in the *entire* market property"; (p. 129): "Malakoff expressly undertook to

sell to the stock-claimants what he had individually acquired from Nazareth and what he himself owned".

The fact is that he did not own or pay for any part of the venture, realty or stock of the corporate debtor which he could legally sell or convey or assign.

Malakoff had no substantial funds of his own and did not have funds wherewith to pay for the purchase price of the Nazareth Market [R. 296].

He solicited investments for the Nazareth Market and as he received money from the innocent investor, he made the payments required to be made to purchase the Nazareth Market. Appendix A shows the payments to Malakoff by the investors and his payments to the Philadelphia Group. Malakoff had always received more money from the investors than he had paid to the Philadelphia Group. He received a total of $160,362. and paid out $49,489 of these funds plus $11,032.84 of Debtor's funds for a total of $60,521.84, to the Philadelphia Group.

From first to last, Malakoff's every action was that of a representative for those persons who gave him their money for investment in Nazareth. The evidence to this effect is overwhelming.

a) Malakoff's first action; his solicitation of investments limited his interest to a share of the profits in the event of a sale

In April, 1951, Malakoff purported to syndicate the purchase of a one-fourth interest in Nazareth for $16,000. The entire sum of $16,000. was contributed by claimant Kanter ($4,000.), claimant Samet ($2,000.), claimant, Gertrude Silver Klein ($2,000.) and others. Malakoff's sole interest in this transaction was limited to a share of the profits in the event of a subsequent sale. Malakoff con-

firmed this himself in his own record of the transaction (see legend "1/3 of profit to office" in Saul, General Debtor's Ex. K—R. 543).

In addition, Malakoff told Claimant Kanter that his interest in Nazareth was limited to a share of the profits in the event of the sale of the property [R. 306-7].

b) Malakoff did not consider himself a principal

On August 1, 1951, Malakoff acknowledged to claimant B. Clark that he was "holding in escrow the sum of $4000. which you have invested with me in the deal in Nazareth, Penna., known as The Nazareth Farmer's & Auction Market (sic)." " " " (B. Clark Ex. 5—R. 569). On September 11, 1951, he acknowledged to claimant Masur that he was "holding in escrow the sum of Four thousand dollars which represents one-fiftieth (1 50th) ownership in the Nazareth Farmer's & Auction Market (sic), in Nazareth, Pennsylvania (Masur Ex. 8—R. 566). Again on September 11, 1951, he acknowledged to claimant Treat "receipt of Two thousand dollars ($2000.) which I am holding in escrow, for 2 200ths of the Nazareth Farmer's & Auction Market (sic), Nazareth, Pennsylvania (Treat Ex. 4—R. 568). Similarly, Malakoff acknowledged to other claimants that he was holding their money in escrow (*e.g.*, F. Como Ex. 4—not printed).

The statements made in these exhibits are not those of a man who was selling part of his own proprietary interest or part of his own stock. If Malakoff were selling what was his own, the money he received on the sale would have been his own and there was no need to hold it in escrow.

c) Malakoff acknowledged that the money he collected from the Nazareth investors did not belong to him

As late as December, 1952 or January 1953, Malakoff had a conversation with Gilbert Sunshine, his accountant. Sunshine brought to Malakoff's attention that the books of the corporation showed no indication of the money collected for the sale of stock. Malakoff replied that when final arrangements were made he would put the necessary moneys in the corporate treasury [R. 429-430].

As was the case with the escrow receipts, if the stock sold by Malakoff were his own, the money proceeds of any stock sale would be his own and there would have been no need for Malakoff to acknowledge his obligation to pay the money over to the corporation.

d) Apart from a share of the profit on a sale, all that Malakoff expected in Nazareth was a management fee

As part of the foregoing conversation with his accountant, Malakoff stated that he contemplated a management fee for supervising the Market plus his expenses. This was what he was to get out of the situation [R. 440-441]. There was no claim by Malakoff that he was entitled to any stock. Apart from a share of the profit on a sale, Malakoff's only expectation was a managerial fee for supervising the market for the investors. It is highly significant that the Examiner fixed Malakoff's status in Nazareth as that of "the managing adventurer" [=141—R. 210].

c) The Examiner has found that none of Malakoff's funds were used to pay for Nazareth, that he obtained financing from others and that his interest was limited to a percentage of the profit from the venture

This finding by the Examiner appears at R. 190. It is amply supported by the foregoing references to the record and the fact that Malakoff himself had no substantial funds of his own [R. 296].

f) The Market was paid for with the funds of the investors

We have seen that Malakoff had no money. The investors now before the court gave their money to Malakoff specifically for investment in Nazareth. Publication of a "bar order" invited the filing of proofs of interest by any persons claiming stock interests in this proceeding [R. 45, 229; Bankruptcy Act, sec. 196].

No other persons have claimed that it was their money which bought the property or was contributed to the venture. The State of Pennsylvania has not claimed the property for want of an owner. The conclusion is irresistible that Malakoff used the investors' money to pay for Nazareth even though it may have been comingled with his own.

Hooley v. *Giere*, 9 Abb. N. C. 8, Note on pages 41 and 42, aff'd 9 Daly 104, aff'd 82 N. Y. 625;
Baker v. *N. Y. National Exchange Bank*, 100 N. Y. 31, 34-35.

g) Malakoff's last action—within 4 months of the filing of the Petition for Reorganization, Malakoff perpetrated a fraud in an attempt to constitute himself the owner of Debtor's stock

Late in May or June, 1953, Richard Hull, Esq., prepared a set of minutes purporting to authorize the sale of the balance of 180 shares of the Debtor's stock to John Malakoff for $75 per share. Hull was a director of the Debtor. These minutes [R. 535-6] were dated in one place July 2, 1952 and in another July 2, 1953. The fraudulent nature of the minutes is obvious from the fact that they were pre-dated and signed by Hull after he had resigned as a director on June 4, 1953 [R. 417-8]. They were prepared with knowledge of the over-issuance of stock by Malakoff and after Malakoff was charged with not putting the money received for the sale of stock into the corporate treasury [R. 419].

The Court of Appeals has branded these minutes as having been "fraudulently prepared and pre-dated" and that "The purported issuance was both fraudulent and invalid" [R. 592].

There is only one conclusion to be drawn from these fraudulent minutes—Malakoff was at no time the owner of any stock or proprietary interest in Nazareth. If he were, there would have been no need to draw the minutes. "Malakoff as the promoter must be regarded as a trustee, fiduciary, agent, promoter or syndicater—(the terminology is unimportant—the facts create the rights) for those who gave him their funds for investment in the project." (Opinion by the Court of Appeals, R. 592-3.) The minutes were drawn to cover up Malakoff's breach of trust in transferring interests in Nazareth, which he did not own, in satisfaction of his personal obligations.

POINT III

Malakoff was a promoter in the Nazareth venture. As such, he was a fiduciary bound to act for the investors and whatever he acquired should be impressed with a trust for their benefit.

Malakoff was a "syndicator" and promoter in real estate transactions. Indeed, he used the very word "syndicate" in his record book to describe at least one of his real estate transactions [Saul, General: Debtor's Ex. K—R. 543]. Petitioners acknowledge that, in the acquisition of the Nazareth Market, Malakoff undertook a real estate "syndication" or promotion [Brief, p. 5]. Malakoff was one who associated investors in the acquisition of real property for sale and profit. He did not invest himself and the Examiner has found that he did not in this case [R. 190].

Controlling are the facts which disclose whether the purchase was in fact made by the promoter himself individually, or by the corporation or with moneys contributed by a syndicate organized for the purpose, the members of which are repaid by a pro rata distribution of the shares in the venture or of the organized corporation. [*Parker* v. *Boyle*, 178 Ind. 560, 99 N. E. 986; *Bigelow* v. *Old Dominion Copper Mining and Smelting Co.*, 74 N. J. Eq. 457, 503.]

The money for the purchase of the Nazareth business and realty and for the 20 shares transferred by Zoloth and Soble to Malakoff came from the investors (see p. 40, *post*). The 20 shares were assigned to the Debtor and never came into the hands of any claimant [R. 592]. Petitioners seize on these 20 shares held by Malakoff, being all the outstanding stock, as justification for his issuance

of all the Debtor's stock [Brief, p. 93]. Aside from the fact that Malakoff was holding those 20 shares for the benefit of his principals who furnished the money for whatever he acquired, the mere fact that all the issued stock of the corporation stood in Malakoff's name did not make Malakoff and the corporation one and the same person. It continued as an entity irrespective of him. *Donaldson* v. *Andresen*, 300 Pa. 312; *Macay* v. *Scandinavia Belting Co.*, 264 Pa. 384.

At the outset, it was not finally decided whether the Nazareth project was to be conducted as a corporation or joint venture [R. 187, 308]. In either case, the promotion was in its organization stages even though the Debtor was already incorporated. In determining the relation between joint venturers, it is the nature of the enterprise undertaken by the plurality of persons that controls. *In re Taub* (C. C. A. N. Y.) 4 F. 2nd 993.

As a promoter, there was a relationship of trust and confidence between Malakoff and the persons whose investments he solicited and, for breaching his fiduciary obligations as a promoter, a trust should be declared in whatever Malakoff acquired in favor of his principals who provided the money. *McCandless* v. *Furland*, 296 U. S. 140; *Davis* v. *Las Oras Co.*, 227 U. S. 80; *Sage* v. *Culver*, 147 N. Y. 241, 246, 247; *Brewster* v. *Hatch*, 122 N. Y. 349; *Getty* v. *Devlin*, 54 N. Y. 403, 413; *Hiller* v. *Calmac Oil & Gas Corp.*, 258 A. D. 78, 84; *Zahorsky* v. *Leschinsky*, 394 Pa. 368; *Fidelity Union Trust Co.* v. *Laise*, 127 N. J. Eq. 287.

The basic principles involved are well illustrated in *McCandless* (*supra*) and *Brewster* v. *Hatch* (1890), 122 N. Y. 349.

From these cases it is apparent that whatever legal sleight-of-hand may be used, a promoter will not be permitted to mulct investors by organizing a corporation

and, with the use of their money, purchase its stock and assets for himself and distribute the stock among his creditors in satisfaction of his personal obligations. Since the stock claimants who were personal creditors of Malakoff must rely on his interest in the Debtor to support their claims, and since he had no such interest, the claims are invalid and must be rejected.

That Malakoff commingled the funds entrusted to him is no bar to relief (*Baker* v. *N. Y. National Exchange Bank*, 100 N. Y. 31, 34-35; *Hooly* v. *Gieve*, 9 Abb. N. C. 8; aff'd 9 Daly 104; aff'd 82 N. Y. 625).

In the note to *Hooly* v. *Gieve*, found in Abbott's New Cases at pages 41 and 42, the rules were stated as follows:

> "The old aphorism that 'money has no ear-mark' which was formerly often assigned as a reason for not allowing a fund after it had been reduced to money and mingled with other moneys is now restrained by the growing recognition of the two just and practicable rules of modern equity, which may be stated thus: 1. Where trust moneys have lost their individuality by being comingled with other moneys, or turned into other property, equity may establish a charge on the entire fund, in favor of the cestui que trust, to the extent to which that can be done without injustice to those having other equities in the fund. 2. In doin gthis it may trace the moneys by all the means that bookkeeping and an equitable application of payments afford, so as to fasten on the resulting fund a charge or lien for the amount diverted, so far as the fund may justly be subjected to the trust, but no further.
>
> "If the trust money is thus traceable, the court will not decline to reach it merely because it has been comingled."

POINT IV

Malakoff and the Philadelphia Group deceitfully conceived, created and used the Debtor corporation to effectuate a fraud on the Debtor's existing and future creditors and stockholders.

The slickness of the scheme engineered by the Philadelphia Group and Malakoff to mulct the investors may be seen from the chronology and character of their maneuverings. This requires a detailed analysis of their conduct.

On April 17, 1951, the Philadelphia Group acquired the business and realty of Nazareth from Richard Realty Co., its dummy [=17—R. 51-2; R. 282-3].

The purchase price according to the closing statement was $66,000, subject to two mortgages totalling $18,500. [Saul, General: Examiner's Ex. G—R. 531; =17—R. 51-2].

The actual cash payment made by Richard Realty Co. was $47,732.99, inclusive of $5000. paid on account and minor adjustments, all of which are reflected on the closing statement.

Zoloth and Soble were dummies for the Philadelphia Group [R. 286-7]. Their books reflected their capital investments (of $40,000), as well as the capital investment (of $17,489) of John Malakoff, which were used to pay the cash required for the purchase price [Saul, General: Examiner's Ex. BU—R. 507].*

* John Malakoff's capital was furnished by Kanter, Silver, Samet and others as reflected on his record book [Saul, General: Debtor's Ex. K—R. 547; Finding No. 3—R. 230]

At this point, the first step on the road to fleece the public was taken. In July, 1951, John Malakoff orally agreed to purchase the Nazareth business and real estate for the same $66,000. paid by the Philadelphia Group plus "an unresolved amount" [Finding =7—R. 231]. Shortly after this oral agreement, arrangements were made for the organization of a corporation (the Debtor) to take over the Nazareth property and business; in anticipation thereof, the capital investments of Soble and Malakoff were converted to loans [=21—R. 52-3, Saul, General: Examiner's Ex. BU—R. 507].

Thus, Soble's original capital investment of $40,000. and Malakoff's original capital investment of $17,489. were converted to loans. These loans, in effect, represented the purchase price of the property. To the loans was added $9,794.64 expended for repairs. After allowance for depreciation and the allocation of $1500. of Soble's loan to capital, the total loans appearing on the Zoloth and Soble books on August 7, 1951 amounted to $57,135.92 [=25—R. 54; Saul, General: Examiner's Ex. 1—R. 533].

It must be remembered that the cash paid by the Philadelphia Group for the business and realty was $47,732.99. There seems little doubt that the $9,794.64 expended for repairs less the allowance for depreciation represented the "unresolved amount" to which the District Court referred. After allowing for repairs and depreciation, the loans of $57,135.92 in reality represented the purchase price of the Philadelphia Group.

The second step was now taken.

The Debtor had been organized on or about August 1, 1951 [=22—R. 53]. On August 9, 1951, at a meeting of its directors, 20 shares of the Debtor's stock were issued

equally to Zoloth and Soble on the basis of the assets (the Nazareth business and realty) and liabilities listed on their balance sheet. *The Debtor* (not Malakoff) *assumed payment of the loans* and Soble's $1500.00 was applied to the payment of the 20 shares of stock [=24, 25—R. 53-4].

The loans, now assumed by the Debtor, were the same loans appearing originally as capital investments on the books of Zoloth and Soble and, with the adjustment for repairs and depreciation, continued to be representative of the purchase price.

The loans payable on the Debtor's books were carried as receivables on the books of the Philadelphia Group [Saul, General: Examiner's Ex, J—R. 537].

At this point, the corporation was rendered insolvent and remained insolvent up to the time of the filing of the petition.

In 1951, with a net worth of $1500., it was obviously under-capitalized. It is just as obvious that it could not pay its obligations because current liabilities were $4,758.16 and current assets, consisting of cash in bank and on hand amounted to $1,217.17. There were no accounts receivable. Current liabilities exceeded current assets by $3,340.99. Thus, as a matter of fact, the Debtor was undercapitalized and was equitably insolvent [R. 512-513].

In 1952, liabilities exceeded assets so that the Debtor was insolvent in a bankruptcy sense. In fact, it was overdrawn at the bank and its current assets of $50. on hand could not possibly meet $1,024.37 in current liabilities [R. 514].

In 1953, Debtor was still overdrawn at the bank. Excluding a questionable account receivable from Malakoff

amounting to $11,811.78, current assets were exceeded by current liabilities [R. 518]. The Debtor could not pay its bills as they became due [R. 400].*

The third step was now taken.

On October 17, 1951, Malakoff purchased the 20 shares of stock owned by Zoloth and Soble for $32,853.08. [Saul, General: Debtor's Ex. F—R. 540.] The stock certificates were endorsed over to Malakoff but were held in escrow and the Philadelphia Group also retained the corporate books and books of account [#30—R. 55-6].

The fourth step was now taken.

Although Malakoff had solicited the funds of Kanter and others in April 1951 [Saul, General: Debtor's Ex. K —R. 547, Finding #3—R. 230], he continued in earnest to solicit the funds of investors for investment in Nazareth. All told, from the beginning of his solicitation to March 25, 1953 Malakoff solicited and received $160,362. from the investors [Appendix A]. As he received this money, he made payments to the Philadelphia Group in reduction of the loans carried on their books. Up to February 15, 1962, Malakoff paid $49,489. and the Debtor paid $11,032.84 to the Philadelphia Group in reduction of the loans. The total payment amounted to $60,521.84 [Appendix A].

Although Malakoff's payments to the Philadelphia Group were reflected in its books, [Saul, General: Exam-

* During the period from 1951 to 1953, creditors of the Debtor had no fund to look to for the payment of their debts because the money of the investors, which should have reached its treasury, were either paid over to the Philadelphia Group or kept by Malakoff. [*Topel* v. *Coleman*, 229 F. 300, 304, cited with approval in *McCandless* v. *Furland*, 296 U. S. 140, 162; *Bingaman* v. *Commonwealth Trust Co.*, 15 F. 2nd 119.] Thus, the interests in Nazareth purchased by the investors were worthless.

iner's Ex. J—R. 538-9] and the loan of $57,135.92 were not only paid but overpaid, *there was no corresponding reduction made of those same loans on the books of the Debtor.*

The fifth step saw the loans on Debtor's books as owing to Malakoff instead of the Philadelphia Group. This was done sometime before June 30, 1952 when the exact balance appearing on the Zoloth and Soble books as loans appeared on Debtor's books as owing to John Malakoff [=37—R. 57; Cf. Saul, General: Examiner's Ex. BU—R. 507 and Saul General: Examiner's Ex. BY R. 514, 516, 518].

The sixth step was the delivery of Nazareth's books by the Philadelphia Group to Malakoff in December, 1952 [=30—R. 56].

The seventh step was the issuance of stock certificates by Malakoff beginning in February 1953 to investors and non-investors alike [Saul, General Examiner's Ex. 4 not printed].

The eighth and last step was taken late in May or June, 1953 when Malakoff's game was up. He caused the preparation of a set of predated minutes which purported to have all the Debtor's stock issued to him by reducing the loan on Debtor's books which appeared as owing to him. The Court of Appeals has found these minutes to be fraudulent [R. 592].

Malakoff and the Philadelphia Group gyrated along their fraudulent road from one entity to another and from one transfer to another with this result:

The conversion of the capital investments in Nazareth resulted in an obligation imposed on the Debtor and the investors to pay twice for the same property.

Putting it in the simplest terms, the purchase price was $57,135.92 which was carried on the books of the Philadelphia Group as a loan. This was the same loan assumed by the Debtor when it issued twenty shares of stock to Zoloth and Soble.

Malakoff paid for that loan with investors' funds.

The Philadelphia Group knew as early as April, 1951 that Malakoff was using the funds of others in acquiring the Nazareth business and realty [R. 306]. They knew also that of the $60,521.84 they received in payment of the loan, $11,032.84 consisted of windstorm insurance proceeds and was paid by the Debtor [R. 285]. With this knowledge, they connived with Malakoff so that the loan appearing on Debtor's books as owing to them was changed to appear as owing to Malakoff. This was done by June 30, 1952.* The change could not have been accomplished by Malakoff alone. The help of the Philadelphia Group was necessary because the Debtor's books of account were in their possession until December 1952 [=30—R. 56].

The extent of their dishonesty may be judged from the fact that during all the times they were noting payments in reduction of the loan on their own books, the Philadelphia Group never made corresponding notations on the books of the Debtor whenever any of the reducing payments were made.

We have, therefore, Malakoff using the investors' funds and the Debtor's funds to pay off the Debtor's loan obligation to the Philadelphia Group. Instead of marking it paid, the Philadelphia Group transferred the obligation to Malakoff. The Debtor was thereby left in the position of being once again required to pay for the

* Conceded in petitioners' brief on page 15.

same loan to Malakoff. In effect, the Debtor and the investors were placed in the position of having to pay the purchase price for the market property twice—*once*, by the payment by Malakoff to the Philadelphia Group with the investors' money which should have reached Debtor's treasury and, a *second time*, as loans owing to Malakoff on Debtor's books which in fact represented the same purchase price already paid with the investors' funds to the Philadelphia Group. Essentially, it was the investors as equitable owners of the Debtor who were placed in jeopardy of paying again for the same property. This was the result sought to be achieved by Malakoff and the Philadelphia Group and it was only prevented when Malakoff came to the end of his crooked road in June of 1953.

Not only did the scheme create the jeopardy of a double payment but even more important it placed Malakoff in a position where he had color of title to the only issued shares of Debtor's stock and in a position to obtain color of title to all of the Debtor's stock as well as the loans on its books.

Already noted is the fraudulent nature of the predated minutes caused to be prepared by Malakoff in an attempt to use the loans on Debtor's books as the justification for the issuance of all Debtor's stock to himself. The fictitious nature of the loan is evident from yet another source. At the end, when Malakoff's frauds were discovered in June, 1953, he assigned to the Debtor the 20-shares of stock he received from Zolath and Soble and also released the loan on Debtor's books [=37—R. 57]. In releasing the amounts allegedly owing to him by the Debtor, Malakoff himself knew there really were no loans owing to him. He described his claims as being "for services rendered" [Saul, General: Debtor's Ex. Q—R. 555].

Petitioners recite [Brief, p. 15] that on October 17, 1951, when Malakoff purchased the 20 shares of stock from Zoloth and Soble for $32,853.08, that "In addition, Malakoff personally assumed liability to the Philadelphia Group for the 'loans payable' to them". This is not true. The contract for the sale of the stock [R. 540] contains no such provision. Moreover, by October 17, 1951, the Philadelphia Group had already received $34,989. from Malakoff [Appendix A] leaving a balance due on the loans of $22,146.92. How can it then be said that Malakoff assumed to pay $57,135.92 when only $22,146.92 was due? Further, the total loans of $57,135.92 included $17,489. previously converted from "his" capital investment. Thus, of the balance of $22,146.92, the sum of $17,489. was ostensibly due Malakoff. Petitioners' contention that Malakoff assumed payment of the total loans is ridiculous because Malakoff would not assume to pay a loan due to himself.

There is another matter of fact in connection with the purchase of the 20 shares which merits some comment. The Examiner erroneously found that the total price of Nazareth to Malakoff was $89,989. consisting of the loans of $57,135.92, plus $32,853.08 for the stock [3]. This was rejected by the District Court which found the price to be $66,000., plus an unresolved amount [R. 231]. The reason for the rejection seems clear. Malakoff had agreed to purchase the Market business and realty in July, 1951 for $66,000. That was the price. When he purchased the stock for $32,853.08 on October 17, 1951 there was no reason to add the price of the stock to the price for the Market previously agreed on in July 1951. It would be more consistent to apply the price of the stock to the previously agreed upon price. *The contract for the sale of the stock was merely a change in the format of paying*

the cost of the property. This is fortified by the fact that nowhere in the findings of the District Court was there any mention made of the price of $32,853.08 for the stock.

Petitioners profess to be concerned with the realities in Nazareth [Brief, p. 92]. They point to the so-called loan appearing on Debtor's books as a credit to John Malakoff which he released. From this they argue that the first 20 shares were split 10 for 1 and that the 20 authorized shares "should have been capitalized at no less than $60,000. after Malakoff released the loan" [Brief, pp. 92-93].

This is pure fiction. In the light of what has been demonstrated, all the euphemisms in the world cannot cover the fact that Malakoff and the Philadelphia Group were frauds.

POINT V

A Bankruptcy Court as a Court of equity may, in a proper case disregard the corporate entity or pierce the corporate veil.

The evidence discloses:

1. That Malakoff dominated and controlled the Debtor [=129—R. 204].

2. That to the majority of investors, it was no more a separate entity than it was to Malakoff; they considered themselves as investing in Nazareth as a business enterprise in a joint venture with Malakoff as the managing venturer [=130—R. 205; =131—R. 206; =138—R. 208].

3. Malakoff and the investors understood and agreed that at the most, the debtor was merely a transitory

vehicle, receptacle or conduit holding technical title to the Nazareth business and realty for all the joint venturers and that title might be and could be transferred to another vehicle such as a limited partnership.

> "On the other hand, I may cause the dissolution of the corporation and arrange the formation of a limited partnership and your shares will be applied as your contribution with a corresponding proportionate 'interest' " [R. 187].

Investors gave him contributions under those conditions before, during and after the purchase of the Nazareth Realty and business [=130—R. 205].

In said receipt, he further stated:

> "Under our arrangement, I am obliged to you for a proportionate share of my earnings, dividends, liquidating or otherwise, and profits from the market as I receive them" [R. 186].

4. Malakoff was not selling shares of stock; he was selling fractional interests in Nazareth with a 20% annual return based on the amount of money invested by each buyer of an interest [=127—R. 204].

For stock purposes, he did not consider the Debtor as a legal entity separate and apart from himself [=129—R. 204]. The Debtor and Malakoff were alter egos [=133—R. 206].

5. The Debtor was conducted as a *de facto* corporation; it never completed its organization by the regular issuance of stock, the regular election of directors and officers, the regular conduct of meetings of stockholders and directors and other corporate activities [=131—R. 206].

The plan conceived by Malakoff and the Philadelphia Group involving the purchase and sale of the Nazareth property was a fraud, rendered the Debtor corporation insolvent from its very inception to its demise and was a fraud on its creditors and investors [Point IV, *ante*].

The investors, whether they were buying shares in a venture as claimed by the Debtor, or the Debtor stock, or Malakoff's interest as claimed by the petitioners, were buying absolutely worthless pieces of paper [Point IV, *ante*].

Thus, the Debtor corporation was deceitfully conceived, created and used as a means to effectuate a fraud. If we take into consideration the further facts that the investors and Malakoff agreed that the Debtor corporation was a mere transitory vehicle for the Nazareth property, and that most of the investors were buying an interest or share in the Nazareth market, business, or venture, this Court, in all good conscience and equity, should disregard the corporation or pierce the corporate veil and treat the transaction as a joint venture. A trust should be imposed on the only asset of that venture, the Nazareth property and business, thereby enabling this Court to look to the real substance of the issues and facts involved, and not to the *inapplicable*, highly technical statutes and decisions of state courts presented by the petitioners.

Because of technical requirements under Chapter X of the Bankruptcy Act, the Debtor was required to file its petition as a corporate Debtor and for that reason only.

The Federal Courts have disregarded the corporate entity to do equity in bankruptcy and in other cases.

Fitzgerald v. *Central Bank & Trust Company* (C. A. 10th 1958) 257 F. 2nd 118;

Selected Investments Corp. v. *Duncan* (C. A. 10th 1958) 260 F. 2nd 918, cert. den. sub. nom. 359 U. S. 914 (1959).

All states including Pennsylvania and New York have pierced the corporate veil or disregarded the corporate entity to do equity and substantial justice.

The very law of Pennsylvania, which petitioners would have applied here, invokes the broadest kind of equitable application of the principle of disregarding the corporate entity and piercing the corporate veil. For all practical purposes, they disregard the corporate entity theory where equity and justice require it.

In *Tucker* v. *Binenstock*, 310 Pa. 254, 263, the Court held that there is an exception to the fiction that a corporation is an entity distinct from the aggregate of individuals comprising it and that this fiction will be disregarded and the individuals and corporation treated as identical whenever justice or public policy demand it and when the rights of innocent parties are not prejudiced thereby nor the theory of the corporate entity made useless. See also: *Williams* v. *Rose*, 403 Pa. 619, 624; *E. Silk Mfg. Co.* v. *First N. B. & T. Co.*, 338 Pa. 139, 143; *Markovitz* v. *Markovitz*, 336 Pa. 122; *Love* v. *Clayton*, 287 Pa. 205, 213.

New York Courts have looked behind or disregarded the corporate form where equity and justice require it. *Goss & Co.* v. *Goss*, No. 2, 147 App. Div. 698; *Barkin Const. Co.* v. *Goodman*, 221 N. Y. 156.

In *Hodlin* v. *Licht*, 224 App. Div. 614, the Court stated at page 615:

> "The parties were essentially joint adventurers, and, as such, owed the duty of utmost good faith

> to each other. They were accountable for secret profits." (Selwyn & Co. v. Waller, 212 N. Y. 507.) Where as in this case, the defendants' conduct was not honest, equity will look behind the corporate form and consider the parties in their real relation to each other (Goss & Co. v. Goss, No. 2, 147 App. Div. 698). * * * "

The result of piercing the corporate veil or disregarding the corporation would present the Nazareth transaction in its true light and enable this court to do equity and substantial justice.

The fact that some investors gave Malakoff monies for investment for the Nazareth venture before, during or after the purchase of Nazareth, and that he gave more interests than he represented were to be distributed, or more shares of stock than were authorized to be issued, becomes academic because his purchase enures to the benefit of all investors or subscribers in proportion to their actual contributions [*Getty* v. *Devlin*, 54 N. Y. 403, 412, 413]. The time of the purchase of the realty, the time of payment by the investors, the time of delivery of shares of stock or that more than 200 shares were issued are not crucial. Substance must not give way to form [*Pepper* v. *Litton* (1939), 308 U. S. 295, 305].

The stock claimants would be treated as what they truly were—investors as venturers in a joint venture with Malakoff as managing venturer.

The *res* of their investment likewise would in fact come into true focus. This would clearly not be the corporation but the Nazareth business and realty.

The *res* to be distributed, which is in fact the Nazareth business and realty, would be more adaptable to realistic

and simple allowances based on the money invested index used by the Court of Appeals which can easily be translated into shares of stock within the existing framework of the Nazareth corporate structure.

In addition, all of the guilefully and technically created theories of the petitioner relating to State and corporate law (e.g., that a court of equity has no power to cancel the stock certificate * or disallow the interest ** in the debtor corporation of a claimant stockholder) could be justly dispensed with.

POINT VI

Based on fundamental differences, the Court of Appeals properly allowed the claims of investors and disallowed those of the non-investors.

The crucial differences between the situations of the investors as compared with those of the non-investors furnishes every reason for allowing the claims of the investors and disallowing those of the non-investors.

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* It is well established law that a Court of Equity may declare the issuance of fictitious stock void, and have such stock cancelled (*Bingaman* v. *Commonwealth Trust Co.* (M. D. Pa. 1926) 15 F. 2nd 119; *Chemical Lime Co.* (M. D. Pa. 1938) 25 F. Sup. 547; *Frazer Fund* v. *Frazer*, 350 Pa. 553; *Petrishen* v. *Westmoreland Finance Corporation*, 304 Pa. 552; *B & C Electrical Construction Co* v. *Owens*, 176 App. Div. 399, affd. 227 N. Y. 569; *McCandless* v. *Furlaud* (1935), 296 U. S. 140, page 161.

** The petitioners can only contend that the effect of the Court of Appeals disallowance of the claims of non-investors resulted in a cancellation. But a Court of Bankruptcy has the power to disallow creditors' claims and "the interests of stockholders" under §96 of the Bankruptcy Act. The natural result of disallowance would be cancellation or nullification.

Intention to Invest

The purpose of the investors was to purchase an interest in Nazareth.

There was no intention by the non-investors to make an investment in Nazareth. They received their interests in satisfaction of Malakoff's personal obligations to them.

Actual Investment

The investors, through Malakoff, invested their money and made a contribution to the venture. Money was actually passed.

The non-investors did not invest any money and made no contribution to the venture. All that happened was that Malakoff's past due personal obligations to them were satisfied. They received participation in the venture but neither the venture nor the Debtor received anything.

Good Faith and Change of Position

The investors gave their money to Malakoff for the specific purpose of acquiring an interest in Nazareth. Whatever he acquired was theirs. They relied on him for this purpose and they changed their positions to the extent that they parted with money. They were good faith purchasers.

The non-investors received their interests from Malakoff in satisfaction of their personal claims. There was no change in their positions. The allowance of their claims may not be predicated on any theory of estopped against the venture or the Debtor based on any misrepre-

sentations of Malakoff. An antecedent debt does not support a good faith purchase or an estoppel sufficient to cut off prior equities. *Wills* v. *Investors Bankstocks Corp.*, 257 N. Y. 451, 458; *Helvering* v. *Schine Theatre Chain Inc.* (2 C. A. 1941), 121 F. 2d 948, 950). This is conceded by the petitioners (Brief, p. 87).

The Nazareth project was a joint venture (=138—R. 208) and, at most, Malakoff was the "managing venturer" (R. 206). The investors relied on him as representative of the venture to acquire their interests. Whatever he acquired was theirs. The non-investors were engaged in a private and personal transaction to which the venture or the Debtor corporation was a stranger. This was evident or should have been evident to the non-investors, whose personal claims against Malakoff were being satisfied with venture or corporate interests. Under such circumstances, Malakoff, as agent for the venture or the Debtor corporation, could not bind his principal where he was known to be acting for himself. *Manhattan Life Insurance Co.* v. *The Forty-Second Street Company*, 139 N. Y. 146, 151; *N. Y. and New Haven R. R. Co.* v. *Schuyler*, 34 N. Y. 30, 50.

Effect on Debtor's Creditors

Creditors have the right to look to the money value of a corporation's paid up capital as a trust fund for the satisfaction of their claims. This is the law in the Federal courts, in New York and in Pennsylvania. (*First National Bank* v. *Cornell*, 8 A. D. 427, 430, 431; *Tejel* v. *Coleman*, 229 F. 300, cited with approval in *McCandless* v. *Furland*, 296 U. S. 140, 162; *Bingaman* v. *Commonwealth Trust Co.*, 15 F. 2d 119; *Columbia Bank's Estate*; 147 Pa. 436, 23 Atl. 625, 626, 628.)

By statute, in New York and Pennsylvania, the issuance of corporate stock requires value to the corporation (Pa. Constitution, Art. XVI, S. 7; New York Stock Corporation Law, Section 69).

In the case of the investors, money was intended to be paid and was actually paid and therefore constituted, or could have constituted, a trust fund for the payment of creditors.

In the case of the non-investors, no money was paid. Further, no money was intended or could have been paid to the Debtor by the non-investors because the satisfaction of Malakoff's personal obligations could not have resulted in anything being paid into the Debtor's treasury and therefore did not constitute, nor could it have constituted, a trust-fund for the payment of creditors.

Effect on Malakoff's Creditors

If Malakoff were the owner of the Nazareth project, all of his creditors would be entitled to share in it on an equal basis. However, Malakoff was not the owner. To allow claims on the basis of satisfaction of Malakoff's personal obligations would spread the ownership of the Debtor's stock to all of Malakoff's creditors as well as among all the creditors of any corporation Malakoff had anything to do with. For example, Seymour Forman received stock from Malakoff as security for loans made to the Wales and Ambassador corporations [R. 315-17].

If any of the Nazareth claims of Malakoff's creditors are allowed, the result would be a preference over all of Malakoff's creditors because he was insolvent [=37—R. 57].

This proceeding does not involve the matter of John Malakoff as a bankrupt or in reorganization. We are

here concerned with determining the legitimate owners of the Debtor. Both in principle and as a matter of practicality there is no occasion for going beyond this limit by adjudicating the personal affairs of John Malakoff.

Petitioners suggest [Br., p. 923] that the 20 shares of stock held by Malakoff "should have been" recapitalized on the basis of the loans appearing on Debtor's books as being loaned to Malakoff. The "loans", however, had been paid off (*ante*, p. 38) and no longer existed. Therefore, the suggested recapitalization could add nothing to the Debtor's treasury to which creditors could look to as a fund for the satisfaction of their claims. As was stated in *Tepel* v. *Coleman*, 229 F. 300, at page 304:

"This doubtless is not valid even so far as it concerns the corporation, much less as against the trustee in bankruptcy who here stands for creditors of the corporation. *Guarantee T. & T. Co.* v. *Dilworth Coal Co.*, 235 Pa. 601, 84 Atl. 516."

Moreover, Malakoff himself attempted what amounts to the recapitalization suggested by petitioners when he caused a pre-dated set of corporate minutes to be drawn. The Court of Appeals found the minutes and the purported issuance of stock to Malakoff to be invalid and fraudulent [R. 592].

The recapitalization suggested by petitioners is the very situation which the Pennsylvania Constitution, *supra*, and statutes were designed to prevent. In *Zweifach* v. *Scranton Lace Company*, 156 F. Supp. 384, 391, quoting *Grafton* v. *Masteller*, 232 F. 2nd 773, 775, the Court pointed out:

> "The constitutional and statutory provisions * * * were designed to prevent unscrupulous persons from fraudulently issuing and placing on the

market * * * stock not fairly representing money or property received by the corporation." *Big Spring Elec. Co.* v. *Kitzmiller*, 1920, 268 Pa. 34, at page 38, 110 A. 783, at page 784; cf. *Memphis & L. R. R. Co.* v. *Dow*, 1887, 120 U. S. 287, at pages 297, 298. 7 S. Ct. 482, at pages 486, 487; 30 L. Ed, 595."

A corporation may not issue stock for its antecedent indebtedness. *In re Paul Delaney Co., Inc.* (W. D. N. Y. 1927), 23 F. 2nd 737. Neither may a corporation issue stock for a corporate indebtedness to an officer. *In re Progressive Wall Paper Corp.* (2 C. A. 1946), 229 F. 489.

Contributions to the Estate Are Required for the Allowance of Stock Claims

The non-investors paid nothing and having made no contribution they are not entitled to a decree awarding them ownership in any portion of the estate in reorginzation.

The Money Invested Index

The money invested index used by the Court of Appeals was proper.

Petitioners complain about the allowance of claims on the basis of the amount of money invested [Brief, p. 40]. The use of a money index in the making of an equitable determination is by no means novel.

Getty v. *Devlin*, 54 N. Y. 403, was a case involving the application of equitable principles in a case turning on a fraudulent land promotion which was similar in principle to the Nazareth situation.

In *Getty*, the New York Court of Appeals stated [p. 415]:

> "The balance (over the purchase price) equitably belongs to those who paid the money * * * ".

Parenthetically, in granting a new trial, the Court of Appeals in *Getty* observed for the benefit of the Trial Court that

> "It may also be that there should be a re-distribution of the stock among the bona fide subscribers alone" [p. 416].

This is in line with the distribution made by the Court of Appeals below which awarded stock interests solely to the investors.

There Is No Windfall to the Investors by Disallowing the Claims of Non-Investors

Petitioners argue that the result of the Court of Appeals decision is an unearned windfall to the investors whose claims were allowed and point to claimant Weinstein as an example [Brief, p. 48].

In 1952, Nazareth liabilities exceeded its assets [R. 514].

In 1953, there was a surplus of $11,077.68 [R. 518] but Nazareth could not pay its debts as they became due [R. 400].

The fact is that during all that time Nazareth was insolvent and Weinstein had a 4.365% or a 3.5% interest in nothing.

There is no windfall. Had there been no fraudulent maneuvering by Malakoff, it is reasonable to expect that 200 shares would have been sold and $200,000. paid into the venture or into the Debtor's treasury. This might have consisted of the property purchased for $66,000. and the balance would be cash for a total of $200,000. Under these circumstances, Weinstein would have been the owner of a 3.5% interest worth $7,000. Petitioners' arithmetic is wrong. Weinstein's percentage interest under the Court of Appeals decision is $7,000. over $160,362. which was the total money value, inclusive of the Margolis and Shongut allowance, of the stock claims allowed. This amounts to 4.365% instead of 4.79% as computed by petitioners. However, what Weinstein was awarded was 4.79% of Nazareth which in 1951 had a net worth of $1500. what with mortgages and loans on its books and with current liabilities in excess of current assets [R. 513].

Cost, though not conclusive, is evidence of value. *McCandless* v. *Furland*, 296 U. S. 140, 158. *Arguendo*, even if it be considered that the value of the property was $89,989. which the examiner erroneously found to be due the Philadelphia Group from Nazareth and Malakoff, Weinstein would be entitled to 4.365% of property worth $89,989. which amounts to $3,928.02. This is an outside figure. The property was purchased on April 17, 1951 for $66,000 [R. 531].

POINT VII

Petitioners' contention that Debtor's failure to appeal from the District Court's dismissal of its counterclaim is *res judicata* should not be sustained.

Because of the nature of the *Nazareth* case, Debtor interposed a defense and counterclaim to all of the stock claims. The following is an excerpt of the defense and counterclaim which were contained in Debtor's objections to all of the stock claims:

> "7. That in the event claimant's claim is sustained that he is the owner of shares, then claimant is indebted to the debtor for the sum of $———— the unpaid subscription price.
>
> "WHEREFORE, the Debtor prays that the stock claim No. ——— of ———————— as owner of shares of the capital stock of Debtor be disallowed and that in the event the Court decides that ———————— subscribed to or is the legal or equitable owner of the stock certificate held by him for which the claim is filed, then in that event the Debtor be awarded judgment for the sum of $. . . . . or at the rate of $1000. per share of stock, or such other balance as the Court deems proper and due and owing to the Debtor by the said claimant."

Subsequent to the filing of said objections, Martin H. Philip, Esq., as a principal and as attorney for Rehrig, who had an interest adverse to the Debtor, with the assistance of Melvin Lloyd Robbins, Esq., counsel for the petitioners, commenced a raid on the Debtor's stock in an effort to acquire control over it.

On August 1, 1960, Weinstein, Philip and Danciger had become officers and directors of the Debtor [R. 226-28]. Philip is one of Rehrig's attorneys and, as pointed out in Debtor's brief in #26362, he represents an interest adverse to the Debtor. Thus, Philip acting for the petitioners, who had purchased large blocks of stock from non-investors, and Danciger were in control of the Debtor corporation.

The counterclaims were dismissed by the District Court on October 19, 1960 when the stock claims were decided [IV—R. 243].

The District Court allowed the stock claims of the Rehrig Group in part and of Danciger in full.

When the District Court's order resolving the stock claims was made, the Board of Directors, controlled by Philip and Danciger, did not authorize Debtor's attorney to appeal from that order and even refused to authorize payment of the printing bill incurred for the Debtor [S. M. 12939-40 not printed].* He did submit a brief stating the Debtor's position when the petitioners appealed to the Court of Appeals in an attempt to have a greater number of their shares allowed. Weinstein, however, as President, in the interests of the Debtor had authorized the printing of this brief to the Court of Appeals [S. M. 12941, not printed].* Weinstein, as President, instructed Debtor's attorney to take an impartial and disinterested position irrespective of who might be hurt [S. M. 12967, not printed].* Fortunately, others had appealed from the allowance of the Rehrig and Danciger claims and Debtor had an opportunity, as appellee, to present its version of the claims, both allowed and disallowed.

* Hearing before the District Court on November 6, 1961

Petitioners now claim that *res judicata*, bars cancellation of the stock of non-investors because of the law of Pennsylvania which they claim requires an assessment before cancellation may be effected [Br., p. 99]. They argue that, since the Debtor did not appeal from the disallowance of its counterclaims, it is now concluded on that matter. This is a perversion of the doctrine because Philip and Danciger were serving their own interests and not those of the Debtor when they did not authorize an appeal from the Debtor from whatever number of their shares were allowed by the District Court and from the disallowance of the Debtor's counterclaims. They acted in complete disregard of the duty imposed on Debtor's attorney, as its representative, to object to the allowance of improper claims [Bankruptcy Act §47(8)] and to report to the judge (in this case the Court of Appeals) as to any causes of action available to the estate [Bankruptcy Act §167(3)]. They should not now be heard to cry *res judicata* by reason of the very situation they themselves brought about.

—o—

On the subject of *res judicata*, it may be observed that the treatment of the Margolis and Shongut claims by the Court of Appeals was on the same basis as were those now in issue before the Court. There has been no Petition for Certiorari filed in those cases and the time to do so has expired. The determination as to them is now final.

POINT VIII

The cabal exposed, the final result was that the Debtor and the investors were cheated and Malakoff and his personal creditors obtained muniments of title based on fraud and deceit.

Despite the gyrations of the Philadelphia Group and Malakoff, and the torturous labyrinth of facts and arguments which required deep analysis, the net result of what was accomplished in this venture has been established and is clear:

1. *The Debtor was rendered insolvent from its inception and remained insolvent down to the time of the filing of the petition for reorganization.* This was a fraud on existing and future creditors and stockholders within the purview of the Bankruptcy Act. *What was being sold to the investors were worthless pieces of paper.*

2. *There was no fund to which existing and future creditors of the Debtor could look for the satisfaction of their claims.*

3. *The Debtor and the investors were placed in the position of having to pay the purchase price for the market property twice—*

once, by the payment by Malakoff to the Philadelphia Group with the investors' money which should have reached Debtor's treasury, and

a second time, as loans owing to Malakoff on Debtor's books which in fact represented the same purchase price already paid with the investors' funds to the Philadelphia Group.

Essentially, it was the investors, as equitable owners of the Debtor, who were placed in jeopardy of paying again for the same property.

4. *John Malakoff was fraudulently enriched as follows:*

A. *Malakoff pocketed $101,366.* This resulted from his collection of $160,362 from the investors, out of which he paid out only $58,996 (Appendix A).

B. *At least $62,946.97 of Malakoff's personal obligations were paid with Debtor's stock.* This is exclusive of the amounts included in the disallowed portion of the Margolis claims which are estimated at $35,000. The total is made up from the shares of the following claimants:

$20,000.00—Manoochehrian	—Satisfaction of a loan to a corporation other than Debtor (R. 596).
$12,000.00—Kanter	—Shift of a worthless investment in Ambassador Estates, Inc. for 20 shares of Nazareth stock (R. 61, 2: 336).
$10,946.97—Danciger	—Payment of personal notes of Malakoff (R. 151).
$10,000.00—H. Forman	—Security for Malakoff's debts (R. 596).
$10,000.00—S. Forman	—Stock issued by Malakoff for at least this amount to secure loans of a corporation other than Debtor (R. 161).
$62,946.97 *	

*This list is not complete. It has been most difficult in some cases to determine what, if anything, was personally owed by Malakoff to some of the claimants. For example, Katzenell told 3 different stories regarding his accounts with Malakoff and the District Court was constrained to observe: "They may fit to you, Mr. Katzenell, but they don't fit to me without a shoehorn" [R. 389].

C. *$57,135.92 in loans appearing on the Debtor's books and ostensibly owing to Malakoff.*

5. *The investors contributed $160,362. to the market venture as against the cost of acquisition of $57,135.92 as represented by the loans on Debtor's books.* Dollar amounts in excess of the cost of acquisition have been allowed with the result that the money value of the investors' shares has been diluted to accommodate all persons who contributed to the venture.

This was the result although Malakoff did not invest or contribute one cent of his own money to the Nazareth venture or the Debtor corporation.

Under all of the circumstances, the one statement by petitioners with which the Debtor will agree is stated at page 15 of petitioners' brief—"The transaction shows their (the Philadelphia Group and Malakoff) financial sophistication." Sophistication of this type in the handling of a transaction of this nature is more aptly described as fraud and embezzlement. Only artificially contrived legal sophistication can sustain the arguments and achieve the results desired by petitioners.

CONCLUSION

The decision of the Court of Appeals should be affirmed.

CASE TWO

(No. 26362)

SUMMARY OF ARGUMENT AND POINT I

The Court of Appeals was correct in recommending the retention of successful management.

The Debtor filed its petition for reorganization in September, 1953.

Weinstein was President and Fried was retained as General Manager. The Court of Appeals has found that: "the administration has been successful, gross business having tripled from 1953 to 1959 and profits have risen from zero to $41,269."

Under the management of Weinstein and Fried, the market has changed from an itinerant business with spotty rent collections to the point of high occupancy ratio with reasonably constant rent collections [R. 454].

From a business which was insolvent in 1953, the Debtor has progressed under the management of Weinstein and Fried so that all of its bills are discounted [R. 453-4].

Under the management of Fried and Weinstein, a building was erected in 1956 at a cost of $32,000, for which the Debtor received $60 or $70,000, as insurance when it was destroyed by fire a year later with a resultant gain to the Debtor of some $30 to $40,000 [R. 456].

Martin H. Philip's election as a director and officer of the Debtor was confirmed by the District Court and in addition, the District Court, of its own volition, designated Martin H. Philip in sole charge of the affairs of the

Debtor [R. 227-28, 495]. The District Court also approved Danciger, whose stock claim was disallowed, as an officer and director. The Court of Appeals reversed the placement of Philip in sole charge of Debtor's management.

Philip is counsel to Wilson D. Rehrig, the real party in interest in this proceeding, and is a participant with Rehrig in the purchase of stock of the Debtor [Pet. Br., 8, 9; R. 227, 575-6, 583]. He has represented Rehrig in his negotiations for a preferential lease from the Debtor [R. 458-9]. Rehrig has admitted under oath that if he had a voice in Debtor's management he would use it to serve his own self-interest by giving himself a preferential lease to the detriment of the Debtor [R. 445].

Philip's first allegiance is to his client Rehrig. Where Rehrig is out to gain control of the Debtor for his private benefit, it is nothing less than shocking to confirm his lawyer an an officer and director and to place him in charge of Debtor's management.

The Debtor's position is simple:

In the event of genuine wrongdoing by any director, manager or officer of the Debtor, such director, manager or officer should be removed whether by the Court, the Board of Directors or by both. However, where there was no real wrongdoing but merely a technical accusation which had no substantial merit to it, then a director, manager or officer who was experienced, and who operated the Debtor successfully, should not be removed.

The entire record shows that Weinstein and Fried did not act in violation of their trust but in the interests of their trust and for the protection of the Debtor.

Rehrig, Phillips & Robbins, Esqs., commenced raiding in order to purchase control of the Debtor's stock so that

Rehrig, who was a substantial tenant of the Debtor, would get a preferential lease [R. 296, 459-60].

It was after Rehrig and Phillips bought the stock of the Debtor and attempted to buy more, to gain control, that Weinstein and Fried advised the stockholders not to sell, and in some instances, purchased stock themselves. This was not done for their own pecuniary benefit or immorally [R. 463]. Even the District Court realized that fact when it stated that for equitable reasons Weinstein and Fried would not be compelled to reimburse either compensation or expenses received by them theretofore [R. 498].

The purpose of Chapter X is to effect a rehabilitation of the Corporate Debtor so as to preserve the going concern value of their property and to do so in an efficient and expeditious manner.

A reading of the Senate report (1916 on H. R. 8046, 75th Congress, Third Session, 1938), clearly envisions the maintenance of the going concern value of the Debtor.

From the evidence elicited, it clearly appears that the existing management has operated the Debtor successfully. There has been no determination by the District Court that there was any malfeasance or misfeasance damaging to the Debtor. The sole grounds for the dismissal of Weinstein and Fried by the District Court was that Weinstein and Fried violated Section 249 of the Bankruptcy Act [R. 249, 2574. The Court of Appeals found no wrong doing [R. 582].

It is submitted that the Court of Appeals was correct in determining that §249 of the Bankruptcy Act did not apply to respondents Fried and Weinstein. In addition, the spirit of §249 has not been violated so as to warrant the removal of successful management and in its place

appoint a management adverse to the interests of the Debtor.

Such a result, if accomplished, would be in direct violation of the very essence and purpose of bankruptcy reorganizations, which is to conserve the Debtor's assets and do what is necessary in the best interests of the Debtor.

Conclusion

1. In the interests of the Debtor, Weinstein and Fried should not be removed from management.

2. The decision of the Court of Appeals should be affirmed.

Respectfully submitted,

ALEX L. ROSEN,
Counsel for Respondent-Debtor.

MARVIN N. ROSEN,
On Brief.

APPENDIX A

Payments by Nazareth Investors to John Malakoff From March 14, 1951 to March 25, 1953

(Compiled From Original Exhibits and Part of the Record)

1951	*Name*	*Claimants' Exhibit No.*	*Amount*
Mar. 14	Samet	2	$ 1,500
Apr. 2	G. Klein	5	2,000
Apr. 10	Samet	2	500
Apr. 10	Kanter	5	2,667
Apr. 10	Kanter *		1,333
Apr. 10	Mintz	(Dr's. K in Saul R. 547)	4,000
Apr. 10	D. Graveson		4,000
June 1	D. Clark	2	500
Aug. 1	B. Clark	2 & 3	3,000
Aug. 1	Masur	3	3,000
Aug. 1	B. Clark *		1,000
Aug. 14	F. Como *		4,000
Aug. 14	L. Como *		4,000
Aug. 25	Hull	3	2,400
Aug. 30	Bikales *		5,000
Sept. 1	J. Fried		2,000
Sept. 11	Treat	4	2,000
Sept. 12	Masur	4	400
Sept. 17	M. Klein	2	1,200
Sept. 18	Katie	5	2,000
Sept. 19	Weinstein	4	7,000
Sept. 19	Spielholtz	2	1,200
Sept. 20	Saul	4	3,000
Sept. 20	G. Klein	6	1,200
Sept. 29	D. Clark	2	1,125
Oct. 4	Hull	3	1,200
Oct. 18	Laupheimer	5	4,500
Oct. 18	Laupheimer *		500
Oct. 31	Bluestone	4	2,000
Nov. 2	Kane	6	1,000
Dec. 7	A. Fried	2	1,000
Dec. 20	Rosen	3	3,500
	Ida Margolis ***		9,000

* Payments made by cash.

*** Payment found by the Court of Appeals to have been made [R. 598].

1952	*Name*	*Claimants' Exhibit No.*	*Amount*
Jan. 4	Rosen	6	1,500
Jan. 7	A. Fried	3	1,000
Jan.	G. Klein		500
Jan. 21**	G. Klein	7	2,300
Mar. 5	Rosen	9	1,000
Mar. 11	D. Clark	2	200
Mar. 27	D. Clark	2	500
Apr. 10	G. Klein	8	2,000
July 25	H. Schwartz	3	2,000
July 30	D. Clark	2	550
Oct. 20	A. Fried	3	1,000
Nov. 10	Masur	5	500
Nov. 15	G. Klein	4, 2	6,000
Dec. 12	Laupheimer	4, 2	3,000
Dec. 14 & 15	Pollack	4	7,000
Dec. 16	Pollack	Cash	1,500
1953			
Jan. 14	G. Schwartz	4	2,000
Jan. 14	H. Schwartz	4	2,000
Jan. 25	Spielholtz	3	1,800
Feb. 2	F. Como	Cash	2,000
Feb. 2	L. Como	Cash	2,000
Feb. 17	Kaplan	2	1,000
Feb. 27	Bond	3	1,080
Mar. 4	P. Como	Cash	8,000
Mar. 16	Noire	3	5,000
Mar. 17	T. Schwartz	4	3,000
Mar. 20	H. Forman	7	6,000
Mar. 20	H. Forman	3	5,000
Mar. 25	Grossman	2	2,000
	William McK. Shongut ****		6,287
			160,362

** Total payments including this date $88,025.

**** Payment (cents excluded) found by the Court of Appeals to have been made [R. 598].

Payments by John Malakoff to Edward Malakoff, et al. for Purchase of the Market Property
[Saul. General: Examiner's J-R 537-9]

1951			
June	26	$ 3,750.00	
July	7	10,000.00	
Aug.	16	2,250.00	
Aug.	18	739.00	
Aug.	18	750.00	
Sept.	11	5,000.00	
Sept.	13	5,000.00	
Sept.	21	5,000.00	
Oct.	16	2,500.00	
Oct.	24	2,500.00	
Oct.	25	2,500.00	
Oct.	29	2,500.00	
Dec.	20	2,853.08	
1952			
Jan.	3	2,146.92	
Feb.	15	2,000.00	
			$ 49,489.00
Add: * Payment in November 1951 to Casper Simmers for Nazareth Improvements (Ex's BW, Saul Claim)			9,507.00
Total Payments by John Malakoff			$ 58,996.00

Recapitulation

Total Payments by Nazareth Investors to John Malakoff	$160,362.00
Total Payments by John Malakoff for Purchase of Market Property	58,996.00
Excess received by John Malakoff	$101,366.00

* Does not indicate $11,032.84 representing wind-storm insurance proceeds paid to the Philadelphia Group by the Debtor [#35—R. 57].

APPENDIX B

Text of Statutes Cited

Constitution of the United States, Article I, Section 8, Clause four:

SECTION 8. The Congress shall have power • • •

• • • To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States; • • •

Bankruptcy Act §1 (19); 11 U. S. C. §1 (19).

§1. Meaning of Words and Phrases.

• • • • •

(19) A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts;

Bankruptcy Act §§2a, 2a(2), 2a(7), 2a(9), 2a(15), 2a(21), 2b; 11 U. S. C. §§11a, 11a(2), 11a(7), 11a(9), 11a(15), 11a(21), 11b.

§2. Creation of Courts of Bankruptcy and Their Jurisdiction. a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in

chambers, and during their respective terms, as they are now or may be hereafter held, to— * * *

(2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates; * * *

(7) Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate whenever, under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest; and where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction; * * *

(9) Confirm or reject arrangements or plans proposed under this Act, set aside confirmations of arrangements or wage-earner plans and reinstate the proceedings and cases; * * *

(15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act: *Provided, however*, That an injunction to restrain a court may be issued by the judge only; * * *

(21) Require receivers or trustees appointed in proceedings not under this Act, assignees for the benefit of

creditors, and agents authorized to take possession of or to liquidate a person's property to deliver the property in their possession or under their control to the receiver or trustee appointed under this Act or, where an arrangement or a plan under this Act has been confirmed and such property has not prior thereto been delivered to a receiver or trustee appointed under this Act, to deliver such property to the debtor or other person entitled to such property according to the provisions of the arrangement or plan, and in all such cases to account to the court for the disposition by them of the property of such bankrupt or debtor. * * *

b. Nothing in this section contained shall be construed to deprive a court of bankruptcy of any power it would possess were certain specific powers not herein enumerated.

Bankruptcy Act §§67b, 67c, 67f; 11 U. S. C. §§107b, 107c, 107f:

b. The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or to any State or any subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require

the liens to be perfected by the seizure of the property, they shall instead be perfected by filing notice thereof with the court.

e. Where not enforced by sale before the filing of a petition initiating a proceeding under this Act, and except where the estate of the bankrupt is solvent: (1) though valid against the trustee under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act; and (2) the provisions of subdivision b of this section to the contrary notwithstanding, statutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of such property, shall not be valid against the trustee: * * *

f. (4) The court shall have summary jurisdiction of any proceedings to hear and determine the rights of any parties under this subdivision f and to hear and determine the sufficiency of the property of the estate for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor. Due notice of any hearing in such proceedings shall be given to every depositary and State agency which is a party in interest.'

Bankruptcy Act §§70a, 70c; 11 U. S. C. §§110a, 110c:

§ 70. Title to Property. a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located * * *

c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

Bankruptcy Act §§111, 112, 130(1) 196; 11 U. S. C. §§511, 512, 530(1) 596:

SEC. 111. Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located.

SEC. 112. Prior to the approval of a petition, the jurisdiction, powers, and duties of the court and of its officers, where not inconsistent with the provisions of this

chapter, shall be the same as in a bankruptcy proceeding before adjudication.

SEC. 130. Every petition shall state—

(1) That the corporation is insolvent or unable to pay its debts as they mature;

SEC. 196. After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the court.

Office-Supreme Court, U.S.
FILED
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Supreme Court of the United States

October Term, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,
Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,
Respondents.

In the Matter

of

NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,
Debtor.

REPLY BRIEF FOR PETITIONERS

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

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Debtor.

REPLY BRIEF FOR PETITIONERS

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit

---

In Proceedings for the Reorganization of a Corporation TWO CASES (No. 26362 and No. 27000)

No. 27000—The Respondents' Tergiversation and the Strangers' Fraud

The reasons for the Court of Appeals decision, as expressed in Judge Moore's opinion, have been abandoned by the respondents. They urged upon the Court of Appeals the conclusions of law there adopted. Now they propose new

conclusions, which differ radically from the conclusions of both Courts below. They also propose new findings of fact, in addition to the findings which the Court of Appeals erroneously substituted for the District Court's. Now, in rationalizing the result they obtained below, Weinstein and Fried and the Debtor's attorney, Mr. Rosen, differ radically among themselves. They agree only on avoiding applicable state law, on advocating no-law as the rule of decision, and on pressing to impose on 6 of the 36 stock-claimants a loss caused by a stranger to the proceedings, though all 36 had acquired their Nazareth stock from that same stranger under legally identical circumstances, and though all 36 were equally victims and innocent of fraud.

1. *Rules of Decision*: The answering briefs require that the issues be stated again. The Question Presented to this Court in No. 27000, is: "In a Chapter X reorganization proceeding, in adjudicating claims to stock interests in the debtor, which interests vested under state law prior to commencement of the reorganization proceedings, and where no supervening federal statute or policy exists: Is the federal court (having non-diversity jurisdiction) required to apply state rules of decision in equity? If so, does the application of such state rules of decision extend to remedies as well as rights?" (Wolf Brief at 3)

(a) *Respondents' Answers*: Respondents seem to offer three answers, in the alternative, to the Question Presented. (i) Sometimes they seem to answer, flatly, *No.* That answer would confine the Rules of Decision Act, despite its language, to *diversity* civil actions, for no reason but bankruptcy practice and the alignment of parties. Further discussion is unnecessary (Wolf Brief at 58-80). (ii) Sometimes they seem to answer: *Yes, but* there is *no conflict* of state law and the "federal general equity" applied below. That answer depends on the Weinstein-Fried error in reading the Pennsylvania Business Corporation Law and cases (*discussed infra*, p. 24). (iii) Sometimes they seem to answer: *Yes, and* there

is a conflict of state and federal laws here, *but* federal law is supreme, and a supervening federal policy does exist, *viz.*: *rectify fraud!* That answer disregards the author of the fraud, and implicitly answers a major substantive question here, *viz.*: Does a stranger's fraud invoke certain defenses and remedies of "federal general equity"—particularly the "clean hands" defense and "piercing the corporate veil"—to nullify stockholders' rights vested under applicable state law?

(b) *Fraud and Federal Law*: Fraud there was in the issuance of the outstanding Nazareth stock—committed by John Malakoff *alone*. He died, insolvent, in 1955, never a party to these proceedings. There is no charge—much less proof—that any of the 6 aggrieved stockholders in No. 27000 participated in Malakoff's frauds, or that any of the 6 knew of Malakoff's frauds until Malakoff failed and withdrew from Nazareth—after all the Nazareth stock had been bought, paid for, issued, and delivered. The District Court, in allowing all 36 stock-claims, found no participation in Malakoff's frauds, and no knowledge thereof (with a single reservation as to Fried [R. 157-8, 243]). The Court of Appeals, in disallowing the claims of the 6 aggrieved stockholders, made no finding—or suggestion—of such participation or knowledge.

(c) *"Clean Hands" and "Piercing the Corporate Veil":* Respondents' disquisitions on the truism that a bankruptcy court is an equity court with statutory jurisdiction and inherent power to disallow or subordinate claims "based on • • • an illegal or criminal transaction" (Fried Brief *at* 43) are essentially a reference to the power of an equity court to refuse relief to a plaintiff with "unclean hands." That power is as ancient and inherent as the contempt power. But the doctrine applies to the *litigant's* "hands." It is the wrongdoing of the plaintiff—*not* the wrongdoing of a stranger—which denies a remedy otherwise due the plaintiff by law.

> "* * * That doctrine is rooted in the historical concept of court of equity as a vehicle for affirmatively enforcing the requirements of conscience and good faith. This presupposes a refusal on its part to be 'the abettor of iniquity.' [Case cited.] Thus while 'equity does not demand that its suitors shall have led blameless lives,' [case cited], as to other matters, it does require that they shall have acted fairly and without fraud or deceit as to the controversy in issue. [Case cited.]" [1]

The Chapter X procedure authorizes a "bar order" under § 196,[2] and, in effect, compels a "property" owner (including a stockholder) to file a proof of claim to confirm his title to property in judicial custody. He thereby becomes a plaintiff (so to speak), subject to the "clean hands" doctrine. That is the only substantive effect of bankruptcy procedure and practice.

"Piercing the corporate veil" is kindred or subsumed. The object is to impute an agency relationship or to void a fraudulent conveyance. The crucial elements are fraud and domination—by the litigant, not by a stranger.[3]

If the 6 aggrieved stockholders were themselves guilty of such fraud as would warrant the application of the "clean hands" doctrine, this case would be at an end; indeed, the grant of *certiorari* would have been improvident. It would be frivolous to question a federal court's independent power—and duty—to invoke the doctrine. But the 6 aggrieved stockholders were *not* guilty of fraud. They did *not* share Malakoff's domination and control of Nazareth. They com-

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[1] *Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co.*, 324 U. S. 806, *at* 814-5 (1945, *per* Murphy, *J.*).

[2] *Bankruptcy Act*, § 196; 11 U. S. C. § 596; 52 Stat. 893 (1938).

[3] *See Taylor* v. *Standard Gas & Electric Co.* ["*Deep Rock*"], 306 U. S. 307 (1939, *per* Roberts, *J.*); *Pepper* v. *Litton*, 308 U. S. 295 (1939, *per* Douglas, *J.*); *Sampsell* v. *Imperial Paper & Color Corp.*, 313 U. S. 215 (1941, *per* Douglas, *J.*); *Berkey* v. *Third Ave. Ry. Co.*, 244 N. Y. 84, 155 N. E. 58 (1926, *per* Cardozo, *J.*).

mitted *no* "wrongful or injurious conduct".[4] They had *no* "knowledge as to the [putative] fraudulent character of [Malakoff's] corporation."[5] If Malakoff's transfers of Nazareth stock were fraudulent as against his creditors, the 6 had no knowledge of such fraud, and their antecedent debts were "fair consideration" and "value".[6] The 6 are not seeking priority over the 30 prevailing stock-claimants or any creditors of Malakoff's or Nazareth's. They are seeking parity.[7]

The "clean hands" doctrine is irrelevant. There is no occasion to "pierce the corporate veil". There ends the inherent and independent power of a bankruptcy court, as a court of equity, to disregard the corporate entity or to disallow claims in *Nazareth*.

(d) *Corporate Shares as Stockholders "Property"—Definition by State Rules of Decision*: In *Pearlman* v. *Reliance Insurance Co.*,[8] Mr. Justice Black wrote:

> "* * * Ownership of property rights before bankruptcy is one thing; priority of distribution in bankruptcy of property that has passed unencumbered into a bankrupt's estate is quite another. * * * The Bankruptcy Act simply does not authorize a trustee to distribute other people's property among a bankrupt's creditors. * * * This Court has recently reaffirmed that such property rights existing before bankruptcy in persons other than the bankrupt must be recognized

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[4] *Taylor* v. *Standard Gas & Electric Co.*, *supra*, n. 3, 306 U. S. *at* 322.

[5] *Sampsell* v. *Imperial Paper & Color Corp.*, *supra*, n. 3, 313 U. S. *at* 217, 221.

[6] *Bankruptcy Act*, § 67d(1)(e); 11 U. S. C. § 107(d)(1)(e); 52 Stat. 876 (1938); *Uniform Fraudulent Conveyance Act*, § 3; N. Y. D. & C. L. (12 McKinney's N. Y. Consol. L.), § 272; L. 1925, c. 254, § 1.

[7] *Cf. Sampsell* v. *Imperial Paper & Color Corp.*, *supra*, n. 3.

[8] *Pearlman* v. *Reliance Ins. Co.*, U. S. , 9 L. ed. 2d 190 (1962, *per* Black, *J.*; Clark, *J.*, *concurring*).

> and respected in bankruptcy. [Footnote 11] Consequently our question is not who was entitled to priority in distributions under § 64, but whether the surety had, as it claimed, ownership of, an equitable lien on, or a prior right to this fund before bankruptcy adjudication." [9]

Footnote 11 to that opinion in *Pearlman*, cited *Durham Lumber*[10] and *Aquilino*.[11] In the latter, Mr. Chief Justice Warren had written:

> "* * * The application of state law in ascertaining the taxpayer's property rights and of federal law [I. R. C. § 6323] in reconciling the claims of competing lienors is based both upon logic and sound legal principles. This approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest of its citizens, and the necessity for a uniform administration of the federal revenue statutes." [12]

Where "property" is defined by state law, a dispute over the definition of "property" is defined by state rules of decision.

To determine *What* is property, is also to determine *Who* owns that property. When two persons claim the same property, and the controversy arises from transactions with a judgment-proof third person, the definition of "property" also determines priority to a limited fund for payment or indemnification—and further distributes or imposes business losses. The bankruptcy court, like a diversity court, yields to state law on those questions. *Nazareth* presents the same questions to the Chapter X court as to ownership of corporate stock in a solvent debtor.

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[9] *Id.*, 9 L. ed. 2d *at* 193.

[10] *U. S. v. Durham Lumber Co.*, 363 U. S. 522 (1960, *per* Warren, *C. J.*).

[11] *Aquilino* v. *U. S.*, 363 U. S. 509 (1960, *per* Warren, *C. J.*).

[12] *Id.*, 363 U. S. *at* 514.

Change one element of *Pearlman, Aquilino* and *Durham Lumber*: Suppose the claimants' losses had been incurred, and the fund had been insufficient, because of the *fraud* of an agent of the corporate bankrupt, *not* because of honest business failure. The bankrupt and the defrauding agent are still not claimants to the fund. Would state rules of decision no longer determine ownership of the fund? The respondents in *Nazareth* would answer, Yes. That is their case here.

2. *Validity of 200 Outstanding Shares of Nazareth Stock*: The foundation for the decision below was that *all* outstanding shares of Nazareth stock were *void* for lack of consideration to the issuer. Judge Moore wrote (*e.g.*):

> "* * * These shares as a matter of Pennsylvania law could have had no validity as an original issue. * * *" (R. 591)

> "* * * But no such shares were ever validly issued to Malakoff. * * * There is no proof that Malakoff ever paid for these shares or that they were legally issued. * * * The purported issuance was both fraudulent and invalid." (R. 592)

> "* * * The Debtor's stock for all practical purposes has never been legally issued. * * *" (R. 593)

Now the respondents concede—indeed, Weinstein and Fried urge—that up to 200 issued and outstanding shares of Nazareth stock were *valid*, not void.

> "* * * In the present case the Court of Appeals *could not void* the capital stock. * * *" (Fried Brief *at* 35, n.; *emphasis supplied*)

> "* * * the mere fact that all the issued stock of the corporation stood in Malakoff's name did not make Malakoff and the corporation one and the same person. It continued as an entity irrespective of him. [Cases cited.]" (Debtor Brief *at* 31)

The issued and outstanding Nazareth shares within the authorized limit of 200 shares of stock, were valid. (Wolf Brief *at* 80-100)

3. *Inadequacy and Abandonment of Purchase-Money Resulting Trust*: Having voided all the outstanding Nazareth stock, the Court of Appeals impressed a purchase-money resulting trust on the Market—realty and business—in favor of all 30 prevailing stock-claimants who had allegedly paid the purchase price through Malakoff to the Philadelphia Group. Judge Moore wrote:

> "* * * One group of investors paid Malakoff by check, credit or cash various sums to purchase an interest in the Nazareth *Market*. * * *" (R. 591; *emphasis supplied*)
>
> "Malakoff received the moneys put into his hands by the investors for the specific purpose of the allotment of shares in the Nazareth *Market property. He used some of this money to acquire that property.* Title thereto now is in the Debtor. The court upon reorganization is in a position to give to the investors that which they were originally entitled to receive." (R. 593; *emphasis supplied*)

There are two major legal impediments to the purchase-money resulting trust impressed by the Court of Appeals. One is the New York statute abolishing that form of trust on *realty*. The other is the Pennsylvania (and general) doctrine that no person can qualify as a *cestui* of such a trust unless he had paid the trustee *before* the trustee himself had paid over the purchase money to the seller of the property which is the subject of the trust. Thus, even under Judge Moore's rationale, since Malakoff's last payment of the purchase money to the Philadelphia Group occurred on or before February 15, 1952, those stock-claimants who paid Malakoff *subsequently* could not qualify as *cestuis*—and that would

disqualify almost half the "investors" whose stock-claims were (nevertheless) allowed by the Court of Appeals.

The respondents cope with those two impediments by circumvention; and in doing so, they separate. Weinstein and Fried, having conceded the validity of the Nazareth stock, would now impress the resulting trust on the stock, not on the realty. Besides, they say, New York law would establish the same trust, labelled "constructive trust", because Malakoff was more than a bare recipient of the purchase money. Whether "resulting" or "constructive", the trust could benefit only half the 30 prevailing stock-claimants; for the rules about payment of the purchase-money are the same as to both types of trust in both Pennsylvania and New York.[12a] So Weinstein and Fried acknowledge. Therefore, the other half—or perhaps all 30—are to get their stock-claims allowed by a different route, *estoppel*—not even alluded to by Judge Moore.

> "* * * While the present facts bear more of the characteristics of a resulting than of a constructive trust, unquestionably the New York courts would impose a trust for the benefit of the investors. This trust would be imposed not upon the real property, * * *, but upon the Debtor's capital *stock*. [Footnote:] * * * Here it might be said that the Market on arrival at the corporation was converted from real to personal property." (Fried Brief *at* 34-5; *emphasis supplied*)
>
> "The availability of an *estoppel* to all who made an investment through Malakoff after August 1, 1951, eliminates from the case the question whether those who invested with him after he ceased making payments for the acquisition of the Market on February

[12a] *Foreman* v. *Foreman*, 251 N. Y. 237, *at* 242, 167 N. E. 428 (1929, *per* Cardozo, *C. J.*); *Leary* v. *Corvin*, 181 N. Y. 222, 73 N. E. 984 (1905, *per* Cullen, *C. J.*); *Petrukevich* v. *Maksimovich*, 1 A. D. 2d 786, 147 N. Y. S. 2d 869 (2d Dept., 1956, *memo*). *See* Wolf Brief *at* 110-4.

15, 1952 [footnote], may share with the earlier subscribers in the trust of the corporation's capital *stock*." (Fried Brief *at* 38; *emphasis supplied*)

Unlike Weinstein and Fried, Mr. Rosen does not advocate the purchase-money resulting trust even as an alternative remedy. He, too, concedes that at least 20, and up to 200, Nazareth shares, remain valid and outstanding, and that Malakoff held title to those shares. He, too, would impress a trust on all those shares. But Mr. Rosen's trust requires that the Court, "to do equity", should "pierce the corporate veil" and disregard the corporate entity of his client, Nazareth. He wants this Court to treat Nazareth as a joint venture. Malakoff's trust would arise from Malakoff's being the managing partner of a business enterprise—but without a share of his own. The stock-claimants judicially allowed to participate in Nazareth stock, would be those who made "actual contributions" to the venture. But "contribution" to the "venture" would not be Judge Moore's "contribution" to the purchase price of the Market (the subject of the venture).

"* * * Malakoff was holding those 20 shares for the benefit of his principals who furnished the money for whatever he acquired, * * *." (Debtor Brief *at* 31)

"The fact that some investors gave Malakoff monies for investment in the *Nazareth venture* before, during or after the purchase of Nazareth, and that he gave more interests than he represented were to be distributed or more shares of stock than were authorized to be issued, becomes academic because his purchase enures to the benefit of all investors or subscribers in proportion to their *actual contribution* [case cited]. * * *

"The stock claimants would be treated as what they truly were—investors as venturers in a *joint venture* with Malakoff as managing venturer.

> "The *res* of their investment * * * would clearly not be the corporation but the Nazareth business and realty." (Debtor Brief *at* 45; *emphasis supplied*)

Under Pennsylvania law, New York law, and "general equity", a purchase-money resulting trust cannot exclude the 6 aggrieved stock-claimants, yet include half the 30 prevailing stock-claimants who made their advances to Malakoff subsequent to Malakoff's last payment of the Market's purchase price to the Philadelphia Group. (Wolf Brief *at* 109-115)

4. *Inadequacy and Abandonment of Judge Moore's Grounds for Excluding 6 Aggrieved Stockholders*: The Court of Appeals excluded the 6 aggrieved stockholders, and cancelled their Nazareth shares, because—and only because—their consideration for those shares consisted of credit to Malakoff against his personal antecedent debts to them, and/or investment exchanges with Malakoff personally. If Malakoff (individually or as agent or trustee) held *title* to any valid Nazareth stock, Malakoff could have transferred good title, even in fraud of his *cestuis*, to the 6 as purchasers without notice and for "value"—and "an antecedent or pre-existing obligation * * * constitutes value" in the sale of corporate shares.[13] Hence, Judge Moore's theory required that all the Nazareth stock be absolutely void, and that Malakoff be selling realty, not corporate stock.

> "The Examiner treated Malakoff as the owner and operator of the Debtor and each claimant as having purchased his interest from Malakoff. This erroneous assumption made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory that stock transfers

[13] *Uniform Stock Transfer Act*, § 22(1); N. Y. P. P. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 183(1); 15 Purdon's Pa. Stats. Ann. § 322(1), P. L. 126, § 22(1) (1911). (*See* R 592, n. 3.)

> from Malakoff rested upon adequate consideration if the Stock Transfer Act's definition of 'value' were satisfied. This, however, is not the problem. The Debtor's stock for all practical purposes has never been legally issued. * * * " (R. 593; *accord*: R. 592)

By making *personalty*—valid Nazareth shares—the subject of their respective trusts, and by vesting title in Malakoff, the respondents have side-stepped the New York statute which abolishes resulting trusts on realty only. But in doing so, the respondents have undercut Judge Moore's *sole legal* grounds for reversing the District Court and excluding the 6 aggrieved stockholders, *viz.*: (i) that antecedent debts are not "value" for a good-faith purchase of *realty* from a trustee (*see* Wolf Brief *at* 81-88); and, (ii) that the *realty* constituting consideration for valid Nazareth stock issued under a plan of reorganization, could be earmarked against particular shares (*see* Wolf Brief *at* 88-94).

Having abandoned Judge Moore's rationale altogether, the respondents have had to fabricate different rationales for the result decreed below. At least two emerge.

5. *Malakoff's Capacity—Stockholder-Seller or Triple Agent?* Judge Moore concluded that " * * * Malakoff * * * must be regarded as a trustee, * * *, agent, * * * for those who gave him their funds for investment in the project" (R. 592-3), *i.e.*, as purchase-money resulting trustee for all 30 prevailing stock-claimants in the purchase of the Market realty from the Philadelphia Group as sellers. That conclusion reversed the findings and conclusions of the District Court that " * * * Malakoff [was] the owner and operator of the Debtor and each claimant [had] purchased his interest from Malakoff." (R. 593) Now the respondents propose two different theories of Malakoff's capacity in the Nazareth stock transactions.

(a) *The New Independent Weinstein-Fried Theory—Estoppel*: Weinstein and Fried would raise a purchase-money

resulting trust (or constructive trust)—but on the Nazareth stock, not on the realty, and only for the benefit of half the 30 prevailing stock-claimants. Even Weinstein and Fried cannot guess which of the 30 are true *cestuis*, and for how much in cases where "investments" were made with Malakoff both before and after February 15, 1952 (*e.g.*, Aaron Fried [Fried's father], R. 126-9). Whoever the later "investors" are, they cannot be true *cestuis* of a trust of valid Nazareth stock. Under the Weinstein-Fried theory, their stock is void for lack of consideration to Nazareth.

So Weinstein and Fried advance their estoppel theory. Estoppel, they say, would be available to all 30 prevailing stock-claimants, and would thus obviate identification of the true resulting-trust *cestuis*, and would validate whatever stock those 30 claimed. To deny the remedy to the 6 aggrieved stock-claimants, the estoppel theory elicits still another new proposition, *viz.*:

> "* * * the Debtor is compelled to accept claimants as stockholders only if they dealt with Malakoff as agent of the corporation." (Fried Brief *at* 41)

Now Malakoff would be a *double agent*.

Two facts obtrude, *viz.*: the stock-claimants' payments to Malakoff, not to Nazareth; and the Malakoff-Weinstein letter-receipt:

> "* * * all of the authorized stock * * * has been issued to *me*. I am obliged to you for a proportionate share of *my* earnings, * * *.
>
> "In the course of *my* management of the Market, I may cause to be issued to you *n* shares of *my* present stockholdings. * * *" (R. 186-7; *emphasis supplied*)

To escape the meaning that Malakoff was selling his own stock, Weinstein and Fried "read the letter-receipt *closely*", and spell out Malakoff's double agency:

> "* * * [Malakoff's] representation is not that he is selling to the investors shares previously issued to him. The representation is in effect that, as agent of the corporation, Malakoff is issuing to himself, as agent for the investors [footnote], the entire 200 shares of Nazareth." (Fried Brief *at* 38-39)

"Notice" is their bugbear. So Weinstein and Fried argue that an objective reading of the letter-receipt would indicate Malakoff to have been a double-agent, but not an individual seller. Earlier, in the District Court, Weinstein—the draftsman—*swore* that an objective reading would indicate Malakoff to have been an individual seller (R. 362-3), and that he (Weinstein) himself had acted on Malakoff's representations of selling his own shares (R. 120).

Weinstein and Fried still thrust the 30 prevailing stockholders into an agency embrace with Malakoff. The imputation of the agent's knowledge to his principals, they answer by—silence! Meanwhile, they charge the 6 aggrieved stockholders with "notice" of Malakoff's conflict of interest with Nazareth, to deny them an estoppel *vis-à-vis* Nazareth. But the 6 were purchasers from Malakoff, not Nazareth. For them, the only relevant conflict of interest was between Malakoff and the resulting-trust *cestuis* for whom he supposedly held title to valid Nazareth stock. That "trust"—and conflict of interest—were secret.

Estoppel cannot justify the decision below. (*See* Wolf Brief *at* 20-24, 87-88, 101-9, 114.)

(b) *The New Independent Theory of the Debtor—Joint Venture and McCandless* v. *Furlaud*: Surpassing Weinstein and Fried, Mr. Rosen would make Malakoff a *triple agent* in the Nazareth stock transactions, *viz.*: (A) for Nazareth, (B) for all (not some) of the 30 prevailing stock-claimants, and (C) for the Philadelphia Group, too! Notwithstanding both decisions below, says Mr. Rosen, Malakoff was not a pur-

chaser of the Market from the Philadelphia Group; rather, he and they were partners in a criminal conspiracy to defraud Nazareth and the stock-claimants. Now the sellers of the Market to the joint venture would be Harter and Shope (who sold to the Philadelphia Group). (R. 230) The Philadelphia Group, like Malakoff, would be constructive trustees for the 30 prevailing stock-claimants.

All this is impossible to reconcile with either of the decisions below, or with the new Weinstein-Fried theory. Mr. Rosen's conspiracy between Malakoff and the Philadelphia Group is fiction, akin to Mr. Rosen's fiction of a conspiracy between Malakoff and some of the 36 stock-claimants (R. 47-49)—disproved below, and buried at last.

(i) The gravamen of Judge Moore's opinion, and the chief Weinstein-Fried argument, is that *money* alone—if and only if traced into the Market or the corporate treasury—can justify a "share" of Nazareth. Thus, the 6 aggrieved stock-claimants could acquire no shares from Malakoff because he owned none, and he owned none because he paid no money. Hence the reliance on the resulting-trust doctrine and on the corporate laws on consideration for stock.

Mr. Rosen's joint-venture theory requires "contribution to the venture". The money-only index is gone, perforce. Now private contract, express or implied, controls. Pennsylvania and New York do not restrict the forms of consideration for a joint-venture "share" (by contrast to a corporate share). That is a major reason for the vogue of the limited partnership and the joint venture in public real estate "syndicates".[14]

Assuming (*arguendo*) no payment of money by Malakoff, and the need for monetary consideration for corporate shares: The Pennsylvania and New York case-law would validate a partner's share in a joint venture in consideration of (*e.g.*)

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[14] *See op. cit. Wolf* Brief *at* 5, n. 4; Elliott, Shaken to the Foundations: Prospects for Publicly Owned Real Estate Companies, Barron's, 11/26/62, p. 3; 12/3/62, p. 5; 12/10/62, p. 5.

services alone, past or future, or the bare assumption of liabilities.[15] Malakoff "found" and financed the deal; he took no brokerage. He guaranteed Nazareth dividends, and paid out $36,268.02. (R. 189, 232) He operated Nazareth for two years, without salary. No one expected, or could expect, Malakoff to undertake all that for nothing. How much of Mr. Rosen's joint venture Malakoff was originally entitled to, and whether Malakoff's late oversales could void "shares" he had sold earlier to innocent purchasers, are questions on which no findings of fact were made below.

(ii) The veil to pierce is Mr. Rosen's joint-venture theory. Conspiracy and insolvency are the constituents of his procrustean assimilation of *Nazareth* to *McCandless* v. *Furlaud*.[16] His object is to exclude the 6 aggrieved stockholders. He is sublimely indifferent to the distribution of shares among the 30 prevailing stockholders, *e.g.*, Malakoff's return of $2,216.54 (31.665%) in "dividends" on Weinstein's advance of $7,000 (R. 126) does not budge Mr. Rosen in his conception of Weinstein's $7,000 (not $4,783.46) as a joint-venture "investment" (now unrelated to the realty purchase-price). The District Court also adopted a joint-venture theory, but had a radically different view of the "equities". (R. 192-212; Wolf Brief *at* 120-8.)

Leaning on *McCandless*, Mr. Rosen is hoist with his own petard. The conspiracy in *Nazareth* is fiction (*supra*). The insolvency in *Nazareth* is irrelevant; *cf. McCandless*: "We have assumed in all this that the corporation was insolvent at the beginning of its business life. * * * Even though the company was not literally insolvent, the result would be the same."[17] *McCandless* did not involve disallowances in bank-

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[15] *Melville* v. *Kruse*, 174 N. Y. 306, 66 N. E. 965 (1903, *per* Werner, *J.*); *West* v. *People's First Nat. Bank & Tr. Co.*, 378 Pa. 275, 106 A. 2d 427 (1954, *per* Stern, *C. J.*); *see* 1 *Rowley on Partnership* (2d ed., 1960), § 6.3F; 2 *Id.* §§ 52.26-.28, 52.30, 52.33.

[16] *McCandless* v. *Furlaud*, 296 U. S. 140 (1935, *per* Cardozo, *J.*).

[17] *Id.*, 296 U. S. *at* 163.

ruptcy, or cancellation of stock for lack of consideration. Mr. Justice Cardozo's opening sentence reads: "The suit is by a receiver of an insolvent [Pennsylvania] corporation to compel its *promoters* and their *confederates* to restore illicit gains." [18] Though deciding a diversity suit in a New York federal forum prior to *Erie*, this Court did *not* rest on "general equity" alone, but also on the Pennsylvania Constitution and corporation statutes and cases which established a state cause of action in tort. Liability was imposed *only* on participants in the fraud. The equity receiver did *not* disclaim a corporate remedy in order to indemnify some of the creditors or stockholders for deceit in the promoters' public sales of securities. Rather, he sued as successor to the corporation, and asserted the corporation's right to restitution of diverted corporate assets. Indeed, the major legal problem was whether the corporation, as an entity, was entitled to a money judgment.[19] The realty had *not* been sold to the corporation at the promoters' cost, with the profit only on sales of the securities taken in exchange. Rather, the crux of the fraud was the promoters' sale of the realty to their new corporation at a price vastly in excess of their own cost and its fair market value.[20] The stock had been issued to the promoters for insufficient consideration, or for none; the value of the realty could not even support the bonds and notes. But subscriptions were *not* called, and the shares in public hands were *not* cancelled. In effect, the corporation's receiver undertook to collect the subscription price from the sellers of that stock—*not* from the innocent purchasers.

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[18] *Id.*, 296 U. S. *at* 149 (*emphasis supplied*). (*Quoted in* Wolf Brief *at* 40, 71)

[19] *Old Dominion Copper Mining & Smelting Co.* v. *Lewisohn*, 210 U. S. 206 (1908, *per* Holmes, *J.*) *distinguished* (296 U. S. *at* 157-164; *see* Roberts, *J., dissenting*, 296 U. S. *at* 171-3).

[20] *Accord*: *Getty* v. *Devlin*, 54 N. Y. 403 (1873, *per* Earl, *C.*); *s.c.*, 70 N. Y. 504 (1877, *per* Rapallo, *J.*).

"* * * What was done by the promoters here was in the teeth of a prohibition of the Constitution of Pennsylvania, * * *. True, *the securities are valid in the hands of innocent purchasers, whatever the consideration* [Pa. case cited], * * *.

"* * * Confusion of thought is inevitable unless the position of the wrongdoers as trustees is steadily kept in mind. What is here is something more than a tort of fraudulent misrepresentations to be redressed by the recovery of damages at the suit of the defrauded creditors. What is here is a tort growing out of the fraudulent depletion of the assets by men chargeable as trustees if they have failed to act with honor. There are important differences, moreover, between an over-issue of stock, which may leave the assets unimpaired, and a withdrawal of cash, which puts the enterprise in peril. [Cases cited.] The duty of reclaiming assets so diverted and holding the wrongdoers to their duty as trustees is one that rests on the receiver. * * *

"Furland and Kingston, having made themselves *parties to a scheme* whereby Duquesne was to be despoiled and its creditors were to be defrauded, became *accountable,* we think, for everything that came to them as a result of the conspiracy *in excess of the consideration* furnished on their side. * * * *The shares having been sold to others and the certificates being no longer subject to the mandate of the court, the trust that attached to them has been transferred to the proceeds,* which when paid to the receiver will be used like other assets in reduction of the debts." [21]

The respondents' new theories are evasions of the obvious. Malakoff acted as—and was—a stockholder-seller of Naz-

[21] *McCandless* v. *Furlaud, supra,* n. 16, 296 U. S. at 161, 163, 164 (*emphasis supplied*).

areth shares, as the District Court ruled. (Wolf Brief *at* 120-133.)

6. *Respondents' Naked Reliance on Two Erroneous Appellate Findings of Fact*: While they jettison Judge Moore's conclusions of law and rationale, the respondents cling to his opinion for two key findings of fact—and nothing more.

(a) *Tracing*: Judge Moore wrote:

> "Malakoff received the moneys put into his hands by the investors for the specific *purpose* of the allotment of shares in the Nazareth Market property. *He used some of this money to acquire that property.* * * * " (R. 593; *emphasis supplied*)

The Examiner had written:

> "* * * There is nothing in the record which establishes that any of these payments [by the 36 stock-claimants to Malakoff] became an asset of Nazareth *even indirectly.*" (R. 192; *emphasis supplied*)

(b) *Intention to Invest*: Judge Moore found an "intention" or "purpose" by 30 of the 36 stock-claimants to "invest" in Nazareth *because* those 30 had supposedly intended to acquire a direct share in the Market; the other 6 had bought what Malakoff purported to own, and *therefore* had no such "intention" to invest. In other words, if a man buys an original issue of AT&T stock, he "intends to invest" in AT&T; but if he buys his shares from another stockholder, he does *not* "intend to invest" in AT&T. Meanwhile, Judge Moore himself noted: "The Examiner treated * * * *each* claimant [of the 36] as having purchased his interest from Malakoff." (R. 592, *emphasis supplied*)

(c) *Rule 52(a)*: Respondents have hung their case on Judge Moore's findings of "tracing" and "intention", notwithstanding the appellate setting aside of the District Court's contrary findings of fact which were *not* "clearly

erroneous". Not a word is uttered in any of the three answering briefs about the appellate substitution of findings in the teeth of Rule 52(a), nor about the sheer arbitrariness, in terms and in application, of Judge Moore's classification of the 36 stock-claimants under his own posited findings. (*Wolf* Brief *at* 20-26, 115-120.) The District Court findings, not the Court of Appeals substituted findings, remain presumptively correct on review in the Supreme Court.[22]

7. *Respondents' Quest for New Appellate Findings of Fact*: The respondents' new rationales have thrown them back to the original record—almost 10,000 pages of testimony, plus hundreds of exhibits—to support such propositions as Malakoff's multiple trusts and agencies, the 36 stock-claimants' notice *vel non* of Malakoff's multiple conflicts of interest, the chimerical conspiracy between Malakoff and the Philadelphia Group, Malakoff's share of the joint venture, *etc.* Presumably, this Court will not re-try the case after 86 trial-days below, nor venture to assess the credibility of over 50 witnesses on issues raised here for the first time. However, two matters of fact posited by the respondents require reply, to illustrate the respondents' manipulation of evidence and the District Court's freedom from "clear error" in its findings, especially as to "tracing".

(a) *"Investments" and Windfalls*: The Court of Appeals gave some of the 30 prevailing stock-claimants more Nazareth "shares" than Malakoff had promised them and more than they had paid for. *E.g.*: Weinstein paid Malakoff $7,000 for 7/200 of Nazareth, or 3.5%. (R. 120-6) The decision below gives Weinstein $7,000/$145,987.34, or 4.795% (R. 594) —a 37% windfall over 3.5%. (Wolf Brief *at* 8-9, 47-8, 111, 123-8.)

"The small increase in the proportion of ownership, therefore, cannot be said to be a windfall," the respondents an-

[22] *McAllister* v. *U. S.*, 348 U. S. 19, *at* 20-21 (1954, *per* Minton, *J.*).

swer. (Fried Brief *at* 54.) Mr. Rosen gives the arithmetic: $7,000/$160,362 is "only" 4.365%. (Debtor Brief *at* 52-3.) Whence the $160,362 denominator used as the total of "investments"?

(i) It is simple arithmetic to add the allowances listed in Judge Moore's opinion. "Investments" by 31 of the 36 stock-claimants in No. 27000 (including $4,000 by Kanter) total $130,700. Add $9,000 and $6,287.34 in "investments" by Ida Mae Margolis and Shongut in No. 26962, for a grand total of $145,987.34. (R. 594-5, 598)

By contrast: The respondents represent total "investments" of $160,362.34. *Nine errors* appear from mere comparison of their Schedules with the Court of Appeals' list and order, *viz.*: (A) *Mintz*: Court, $0; respondents, $4,000. (B) *Graveson*: Court, $0; respondents, $4,000. (C) *D. H. Clark*: Court, $3,000; respondents, $2,875. (D) *Masur*: Court, $4,000; respondents, $3,900. (E) *M. Klein*: Court, $3,350; respondents, $1,200. (F) *Karapontso*: Court, $2,000; respondents, $0. (G) *Pollak*: Court, $9,000; respondents, $8,500. (H) *Laupheimer*: Court, $7,750; respondents, $8,000. (I) *H. Forman*: Court, $0; respondents, $11,000. Five stock-claimants' "investments" have been understated an aggregate of $4,875; one "investment" is overstated $250; and three persons omitted from Judge Moore's list are scheduled for an aggregate of $19,000. Thus have respondents evidenced a net increase of $14,375 over the total "investments" of $145,987.34 stated by Judge Moore and based on the District Court's findings. Hence the denominator $160,362.34, *Q. E. D.* (Compare R. 594-5, 598, *with* Fried Brief *at* 56-7, Debtor Brief *at* 65-6.)

(ii) The respondents' Schedules are erroneous not through sloppiness alone. (A) *Laupheimer*: Both Courts below disallowed $250 of Laupheimer's $8,000 "investment" claim. In February of 1951, he had invested $2,750 in a Malakoff deal unrelated to the unborn Nazareth project. In December of 1952, Laupheimer exchanged that old in-

vestment, plus a supposed $250 profit thereon, for 3 shares of Nazareth stock. (The other $5,000 was advanced to Malakoff in October of 1951 for 5 Nazareth shares.) "[Laupheimer] does not contend that he invested more than $7,750 in Nazareth." (R. 120) Nevertheless, the respondents have scheduled Laupheimer's investment exchange of $2,750 and his profit of $250 thereon as direct "investments" of $3,000 in Nazareth. (R. 114-120; *cf.* R. 594; *see* Wolf Brief *at* 116.) (B) *Harry Forman* claimed an "investment" of $11,000 in Nazareth. The District Court allowed him only $10,000: "The sum of $500 was repaid and the bonus of $500 should be deducted." (R. 142) Forman's $10,000 advances to Malakoff in March and April of 1953 were personal loans to Malakoff, secured by Nazareth stock. (R. 136-142) Therefore, the Court of Appeals allowed Forman nothing. (R. 596) Nevertheless, the respondents have scheduled Malakoff's antecedent debts of $10,000 to Forman as direct "investments" of $11,000 by Forman.

(iii) The respondents' scheduling of *Mintz* and *Graveson* as "investors" of $4,000 each, is the nadir. Mintz and Graveson are phantoms. They never filed claims, and they never testified. The names appear in Malakoff's notebook on the same page (R. 547) as the names of Kanter, G. S. Klein, and Samet. (*See* R. 230, 56, 58-60) The cryptic notebook page is the scintilla of evidence relied upon by respondents at this stage to account for the "investments" of Mintz and Graveson. The same scintilla, on its face, also accounts for Malakoff's repayment of those "investments" to Mintz and Graveson prior to his "new deal" in July of 1951. (R. 547, 231, 52)

(iv) The District Court found that Malakoff had advanced $12,489 to the Philadelphia Group on or before April 17, 1951 (when the Philadelphia Group took title to the Market), and another $5,000 on or before May 8, 1951. (R. 56; *see* R. 589) Nevertheless, Mr. Rosen says that Malakoff's first advance to the Philadelphia Group occurred on June 26,

1951, and that Malakoff's advances to the Philadelphia Group aggregated $17,489 not earlier than August 18, 1951. (Debtor brief *at* 67.) Both Courts below found, and Mr. Rosen concedes, that "investments" by stock-claimants (not by strangers) prior to August of 1951 aggregated only $8,500. (*Id. at* 65)

The respondents' scheduling of Mintz and Graveson for $8,000 in "investments", obscures Malakoff's own "investment" of $9,489 prior to August of 1951, and obscures the full 37% windfall to Weinstein.

(b) *Insolvency*: In the District Court and the Court of Appeals, Mr. Rosen was the vigorous proponent that all the Nazareth stock was void for lack of consideration to the issuer. (R. 47-9) Therefore, he argued, the corporation and the outstanding shares should be disregarded. Judge Moore adopted that proposition. Now Mr. Rosen has abandoned it. Instead, he theorizes that the stock, though valid, was worthless, because Nazareth was insolvent at all times from incorporation to Chapter X commencement. Therefore, he still argues, the corporation and the outstanding shares should be disregarded.

(i) Sometimes Mr. Rosen defines "insolvency" as an excess of *current* liabilities over *current* assets. (Debtor Brief *at* 8) The corporation's principal assets—land and buildings—are simply ignored. (ii) Sometimes Mr. Rosen acknowledges the statutory definition of "insolvent", *viz.*: "• • • whenever the aggregate of his property • • • shall not *at a fair valuation* be sufficient in amount to pay his debts."[22a] Nevertheless, he uses *book value* alone. (iii) Malakoff's consideration to Nazareth for the outstanding stock, about $60,000, appears on the Nazareth books as "loans payable", not as "capital". On July 2, 1953, Malakoff released his claims to those "loans payable" and effectually capitalized them. Mr. Rosen's failure to capitalize "loans payable" to

[22a] Bankruptcy Act, § 1(19); 11 U. S. C. § 1(19); 52 Stat. 840 (1938).

Malakoff *on the books, alone* accounts for the posited book insolvency even by Mr. Rosen's novel definitions. (iv) The Debtor's petition for reorganization—verified by Weinstein as president, certified by Mr. Rosen as attorney, and filed on September 28, 1953—annexes a balance sheet based on the Nazareth books and showing: *capital*, $1,500; *earned surplus* (after depreciation reserve of $8,424.81), $7,349.37; *reserve for taxes*, $3,674.69; total, $12,524.06. (R. 13-14, 191, 513-8; Wolf Brief *at* 15-17, 90-94.)

8. *Assessment Prerequisite to Forfeiture of Stock to Issuer*: Under Pennsylvania law, assessment or call is prerequisite to cancellation or forfeiture of corporate shares for lack of consideration to the issuer. (Wolf Brief *at* 94-99.)

(a) The respondents have not so much challenged Wolf's statements of Pennsylvania law, as they have changed them. When Wolf speaks of assessment as a *prerequisite* to cancellation (*ibid.*), the respondents speak of a "substitute" for cancellation (Fried Brief *at* 49). When Wolf speaks of lack of consideration to the issuer (*i.e.*, a stockholder's failure to pay a subscription), respondents speak of fraud to a stockholder (*i.e.*, a fiduciary's diversion of valid, fully-paid stock). Wolf noted the express Pennsylvania law on transfers of subscriptions and on liability of transferor and/or transferee to call or assessment (Wolf Brief *at* 96); respondents say (on no reason or authority) that only a direct subscriber is liable to call or assessment (Fried Brief *at* 49). Wolf noted the corporation's right to cancellation or forfeiture of stock for lack of consideration and/or for overissue alone. Respondents say "equitable cancellation of stock unlawfully issued" is available—*incident to re-issue of the same valid shares*—to a stockholder given a decree of restitution or specific performance against a title-holding fiduciary who defrauded the stockholder, not the corporation.[23] The respondents' theories must confuse a contest

[23] *Fraser Fund* v. *Fraser*, 350 Pa. 553, 40 A. 2d 22 (1950, *per* Stearne, *J.*); *Shipley* v. *Monticue Lines*, 4 Fayette L. J. 293 (C. P., Fayette, 1941, *per* Dumbauld, *P. J.*). (*Cf.* Fried Brief *at* 47.)

among stockholders over ownership of shares, with a contest between corporation and stockholder over validity of shares. Their theories must abuse the captive corporation in order to reduce the total number of valid shares outstanding.

(b) The respondents themselves are at odds (again) on whether the Court of Appeals "cancelled" the stock of the 6 aggrieved stockholders. (*Compare* Fried Brief *at* 45, *with* Debtor Brief *at* 46, 2d fn.)

(c) In disputing the prerequisite of call or assessment prior to forfeiture of stock for lack of consideration, the respondents rely on a repealed statute and a *dictum*. (Fried Brief *at* 43-44, 48.) The repealed statute is § 131 of the old Pennsylvania corporation law,[24] enacted in 1874, repealed in 1933, and in force when the cause of action arose in *McCandless* v. *Furlaud*.[25] The respondents quoted part of § 131 and the first sentence of § 603A [26]—*part* of the 1933 successor "implementing" statutes. The reader may note from those quotations that the Pennsylvania legislature omitted from § 603A (and the rest of the "implementing" statutes) the key words, "all fictitious increase of stock * * * shall be void". Those key words were then, and still are, contained in the Pennsylvania Constitution.[27] They are the words referred to in Mr. Justice Cardozo's *dictum* (relative to *Nazareth*) that "there exists * * * an 'implementing' statute [citing § 131], without restriction as to the form of the remedy." [28]

(d) At last, the respondents resort to analogy to foreign law. "The Constitutions of Arizona and Oklahoma contain

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[24] 15 Purdon's Pa. Stats. Ann. § 131; P. L. 73, § 17 (1874), *amended* P. L. 30, § 4 (1876), *repealed* P. L. 364, art. XII, § 1202 (1933).

[25] *McCandless* v. *Furlaud*, 296 U. S. 140 (1935, *per* Cardozo, J.).

[26] Pa. Bus. Corp. L. § 603A; 15 Purdon's Pa. Stats. Ann. § 2852-603A; P. L. 364, art. VI, § 603A (1933).

[27] Pa. Const., Art. XVI, § 7 (1874, *amended* 1956).

[28] *McCandless* v. *Furlaud*, *supra*, n. 25, 296 U. S. *at* 161.

provisions similar to those of Pennsylvania with reference to the issuance of stock" (Fried Brief *at* 50). So do the constitutions and/or statutes of 48 of the 50 states of the Union.[29] The respondents cite cases under the corporation laws of 12 states outside Pennsylvania (*Id.* at 46-52). Typical is the New York case where the court cancelled outstanding stock on the ground that "Stock may be issued for property or work done, but not for services to be rendered in the future."[30] As to the *grounds* for forfeiture of stock, that is the law of most states.[31] It is *not* the law of Pennsylvania (as the respondents themselves note amid their analogizing).[32] As to the *remedy* for lack of consideration, likewise, it is *not* the law of Pennsylvania. (Wolf Brief *at* 94-99) Indeed, later this year, it will no longer be the law of New York, when the Model Business Corporation Law becomes effective. The new statute contains some provisions similar to the existing provisions of Pennsylvania law requiring assessment prior to cancellation.[33] The New York

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[29] *See* Herwitz, Allocation of Stock Between Services and Capital in the Organization of a Close Corporation, 75 Harv. L. Rev. 1098, *at* 1099, n. 3 (1962).

[30] *B. & C. Elec. Const. Co.* v. *Owen*, 176 A. D. 399, 163 N. Y. S. 31, *at* 32 (4th Dept., 1917, *per* Kruse, *P. J.*), *affd.* 227 N. Y. 569, 126 N. E. 927 (1919). The Court added, "While a certificate of stock regular upon its face, issued by officers or agents having authority to issue stock for the corporation, may in the hands of an innocent transferee become effective, * * *, this certificate in the hands of the original holder was valueless. It was, in effect, like so much blank paper." 163 N. Y. S. *at* 32. *But see Morgan* v. *Bon Bon Co., Inc.*, 222 N. Y. 22, 118 N. E. 205 (1917, *per* Hiscock, *C. J.*).

[31] *See Herwitz, op. cit. supra*, n. 29.

[32] *Petrishen* v. *Westmoreland Finance Corp.*, 394 Pa. 552, 147 A. 2d 392 (1959, *per* Jones, *J.*); *Grafton* v. *Masteller*, 232 F. 2d 773 (3d Cir., 1956, *per* Hastie, *J.*), *cert. den.* 352 U. S. 832 (1956). *See* Wolf Brief *at* 92-5; *cf.* Fried Brief *at* 49.

[33] N. Y. Bus. Corp. L. (6 McKinney's N. Y. Consol. L.) § 503(d); L. 1961, c. 855, § 503(d), *amended* L. 1962, c. 334, § 12, *eff.* 9/1/63.

Reviser's Comment thereon states: "* * * The harsh forfeiture provision of Stock Corp. Law § 68 has been softened * * * by a requirement * * * for a sale of the shares of a delinquent subscriber * * *."

The whole thrust of *Erie* was that state laws differed, and that the federal courts were not to substitute their own conceptions of "reason" and "equity" for state case-law, particularly state-court interpretation of local statutes.

9. *The Debtor as Tool and Meddler—Res Judicata and Incapacity on Appeal*: Mr. Rosen has pierced the corporate veil: by his appearance, he has disregarded the corporate entity of the Debtor, his client. Though a self-professed devotee of *McCandless* v. *Furlaud*,[34] he will not distinguish between a corporation's cause of action and its stockholders' individual causes of action. If this Court affirmed the decision below and granted the relief sought by Messrs. Rosen, Weinstein and Fried, the Debtor would derive no gain or benefit. If this Court reversed the decision below and granted the relief sought by Wolf, the Debtor would suffer no loss or prejudice. Mr. Rosen's very appearance (not to speak of his joint-venture theory) is an essay in anomaly.

(a) Mr. Rosen's theory would raise two causes of action in behalf of the Debtor.

(i) *Fraud:* Mr. Rosen says that Malakoff diverted $101,366 of $160,362 in "investments" which should have reached the Nazareth treasury. (Debtor Brief *at* 67.) Mr. Rosen was retained by the Debtor on July 13, 1953 (R. 188), and by the Debtor in Possession on September 28, 1953 (when the Chapter X petition was filed and approved). (A) In almost two years before Malakoff's death, the Debtor never sued Malakoff. (B) Helen Bernstein was Malakoff's

[34] *McCandless* v. *Furlaud*, 296 U. S. 140 (1935, *per* Cardozo, *J.*).

general agent; much of the "diverted" $101,366 passed through her hands. (R. 192, 231) In almost ten years, the Debtor never sued Helen Bernstein. (C) Mr. Rosen says the Philadelphia Group conspired with Malakoff and participated in his frauds. In almost ten years, the Debtor has never sued any member of the Philadelphia Group. (D) The Debtor's balance sheet annexed to the Chapter X petition, shows "Accounts Receivable—J. Malakoff, $11,811.75" (R. 13), *i.e.*, the windstorm insurance proceeds received by the Philadelphia Group. (R. 191, 589) Those moneys Mr. Rosen treats as Nazareth's, disregarding credit to Malakoff. (Debtor Brief *at* 38.) The Debtor still carries that item as a "current asset." (R. 522) In almost ten years, the Debtor has never sued to collect it. (E) In the District Court, Mr. Rosen charged some of the 36 stock-claimants with conspiracy and participation in Malakoff's fraud. (R. 47-49) He brought counterclaims against only two, Hull and Fried, and against none of the 6 aggrieved stock-claimants. Hull was exonerated of participation in or knowledge of Malakoff's frauds, in fact. (R. 145-6) No such finding was made with respect to Fried. (R. 157-8) Nevertheless, Mr. Rosen undertook to "compromise (*i.e.*, to drop) the Debtor's counterclaims against Fried. (303 F. 2d 152; *see infra*, pp. 32-34.)

(ii) *Assessment:* Under the respondents' own theories, and using their own figures, the only consideration Nazareth actually received for any valid outstanding shares, was $58,996, the total "investments" traced into the Market conveyed to Nazareth. The balance—$101,366—of total "investments" of $160,362, did *not* reach Nazareth in money or property, because "diverted" by Malakoff. (Debtor Brief *at* 67.) The true stock-claimants (whoever they are) who paid Nazareth (contradistinct to Malakoff) $58,996 for their stock, would have their "shares" diluted by allowance of additional "shares" for $101,366. Of the total shares of $160,362 which the respondents would validate, nearly 5/8 would be issued

for *no* "money, labor done, or money or property actually received" [34a] by Nazareth as issuer.

Weinstein and Fried, acting individually and as representatives of the 30 prevailing stock-claimants, argue "estoppel" against Nazareth to support the allowance of 5/8 of the stock without consideration. Mr. Rosen does *not* take issue with that affirmative defense of estoppel asserted against Nazareth, his own client. On the contrary, he argues still another theory ("piercing the corporate veil" *etc.*) to rationalize the identical result and thus affirmatively to support Weinstein and Fried. Meanwhile, he steadfastly rejects a remedy of assessment in favor of cancellation, despite the Pennsylvania law which empowers—and requires—the Debtor's assessment prior to cancellation.

If Nazareth would suffer a loss by the validation of $101,366 in stock without consideration to Nazareth, Mr. Rosen has aligned himself and his client (Nazareth) with an adverse interest. If Nazareth would not suffer a loss by such validation, then neither would Nazareth suffer a loss by validation of the shares of the 6 aggrieved stock-claimants, too.

(b) Mr. Rosen would justify his appearance by claiming the standing of an *amicus curiae*. He would justify the Debtor's (*i.e.*, his) failure to appeal in No. 27000 by lack of authorization from Philip and Danciger (then the two Nazareth directors in addition to Weinstein):

> "* * * The Board of Directors, controlled by Philip and Danciger, did not authorize Debtor's attorney to appeal * * *. [Mr. Rosen] did submit a brief stating the Debtor's position * * *. Weinstein, however, as President, *in the interests of the Debtor* has authorized the printing of this brief to the Court of Appeals [citation]. Weinstein, as President, instructed Debtor's attorney to take an *impartial and disinter-*

[34a] Pa. Const., Art. XVI, § 7 (1874, *amended* 1956).

> *ested position* irrespective of who might be hurt [citation]. Fortunately, others [*viz.*: Weinstein and Fried] had appealed * * * and Debtor had an opportunity, as appellee, to present its version * * *." (Debtor Brief *at* 55; *emphasis supplied.*)
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> "* * * [Philip and Danciger] acted in complete disregard of the duty imposed on Debtor's attorney, *as its representative,* to object to the allowance of improper claims [citation] and to report to the judge (in this case the Court of Appeals) as to any *causes of action available to the estate* [citation]. * * *" (*Id. at* 56; *emphasis supplied.*)

(i) Mr. Rosen did not file notice of appeal for the Debtor in No. 27000 in January, 1961. He did file notice of appeal for the Debtor in No. 26962 (Margolis Group) in April, 1961. (R. 587) He filed briefs in both, and in No. 26362 (removal and compensation). He had no authority from the directors to file notice of appeal or briefs in any of the three cases. Fried appealed in all three. Under Mr. Rosen's argument, Fried's appeal alone would have given Mr. Rosen the same bootstrap in No. 26962 that Mr. Rosen seized in No. 27000. The Debtor's appeal in No. 26962 in April, 1961, and the Debtor's briefs in all three cases, belie Mr. Rosen's explanation of the Debtor's failure to appeal in No. 27000.

(ii) On November 6, 1961 (three days before the Court of Appeals' decision in No. 27000), the District Court denied a petition of the Debtor's for payment of $1,005.02 out of the estate for Mr. Rosen's briefs in No. 27000 in the Court of Appeals, and effectually surcharged Mr. Rosen individually, as a volunteer, for the cost of those briefs. (Mr. Rosen did not appeal.) (Debtor Brief *at* 55.) There are three sound reasons for the District Court's order on printing costs. (A) The Debtor, *qua* appellee, had *no right* to attack the District Court's judgment. (Wolf Brief *at* 100.) (B) The

Debtor had *no authority* to litigate in the Court of Appeals. Though its president, Weinstein, would normally have independent power to authorize litigation in the corporate name and at corporate expense, his power had been duly contained by the express prohibition of the directors against litigation without the board's prior consent.[35] Neither Weinstein nor Mr. Rosen had even asked the other two directors (Philip and Danciger) for consent. Weinstein's authorization was insufficient. (C) The Debtor derived *no benefit* from appeal or argument in No. 27000. The Debtor could benefit only from assessment or restitution—which Weinstein and Mr. Rosen disclaimed, and which the Court of Appeals did not order. (Wolf Brief *at* 100, n. 112.)

(c) By now, no one claims that the 6 aggrieved stock-claimants are liable for restitution. By now, even Messrs. Rosen, Weinstein, and Fried concede that Nazareth received consideration for some outstanding shares. Mr. Rosen asks the Court to disregard the *res judicata* doctrine—not because he seeks assessment, but because he seeks cancellation. With no prospect of a money judgment in favor of the Debtor—and with no prayer therefor by anyone—the Debtor (contra-distinct to its incumbent management) can have no interest in the ownership of its valid, fully-paid, non-assessable, outstanding shares of stock, however fractionalized. Whether the valid Nazareth shares were owned by 36 stock-claimants, or by 30, or by one, should be immaterial to the Debtor—and to Mr. Rosen.

In sum, under Mr. Rosen's tutelage, the Debtor has affirmatively rejected and abandoned every opportunity and obligation (under Mr. Rosen's own theory) to add to the Nazareth treasury. Instead, every cause of action of the Debtor's has been misappropriated by Messrs. Weinstein,

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[35] *See West View Hills, Inc.* v. *Lizau Realty Corp.*, 6 N. Y. 2d 344, 189 N. Y. S. 2d 863 (1959, *per* Dye, *J.*); Goebel, Authority of the President over Corporate Litigation, 37 St. John's L. Rev. 29 (1962).

Fried, and Rosen, with a view to cancelling Nazareth shares —to protect and increase the individual equity and votes of Weinstein and Fried in Nazareth, at the expense of the Debtor corporation. The Debtor, as a distinct corporate entity, is a meddler in No. 27000, without standing. Its use as a captive and tool, can be understood only by reference to No. 26362.

No. 26362—The Respondents' Fraud

1. *Fried's Race-Track and Res Judicata*: Weinstein and Fried argue that the race-track matters alleged by Wolf as alternative grounds for relief in No. 26362, were dismissed on the merits by the Court of Appeals during the pendency of No. 26362, and therefore are foreclosed from this Court's consideration. (Fried Brief *at* 5, 24.) The argument is erroneous.

The race-track rent reductions and diversions were the subject of another petition brought by Wolf, seeking (*inter alia*) an accounting of the rents. Judge Sugarman severed that petition from the removal petition involved in No. 26362. The race-track accounting petition was tried in November, 1960, and decided on June 28, 1961. An order was entered on September 12, 1961. The cross-appeals by Fried and Enterprises (his race-track corporati) and by Wolf, became No. 27248 in the Court of Appeals. During the pendency of No. 27248, and on November 9, 1961, the Court of Appeals decided Nos. 26362, 26962, and 27000 (two of the three cases constituting No. 70 in this Court). By November 29, 1961, when Wolf's petitions for rehearing below were denied, Nazareth appeared to have new stockholders, and Weinstein and Fried appeared to be free to hold office in Nazareth. (Wolf Brief *at* 29-30, 33-7, 165-7, 186a-189a.)

New directors and officers of the Debtor were elected and approved in December. In January of 1962, Fried and his

race-track corporation made an omnibus offer in compromise; they proposed an exchange of releases of all the claims and counterclaims, arising both before and during the Chapter X proceeding, between Fried and his corporation on the one side and the Debtor on the other side. The Debtor accepted the "compromise" and petitioned the District Court for approval. Only the Debtor (*qua* trustee) had authority to petition for compromise in bankruptcy.[36] Only upon new election of directors was the Debtor authorized to do so. On February 5, 1962, the District Court granted the compromise petition (as modified somewhat at the hearing), and expunged (*inter alia*) the Debtor's claim for the race-track back-rents. The Debtor and Fried then moved the Court of Appeals to dismiss Wolf's race-track appeal (No. 27248) as moot. Wolf appealed from the compromise order (No. 27464). The latter appeal (No. 27464) and the motions to dismiss the former appeal (No. 27248) were consolidated and expedited, and were argued together on March 28, 1962. On April 2, 1962, this Court granted *certiorari* in No. 26362 and No. 27000. (R. 602) On May 14, 1962, the Court of Appeals reversed the District Court in No. 27464, holding the February 5th compromise order an abuse of discretion. The Court of Appeals also vacated—not reversed—the District Court's race-track order in No. 27248, and remanded the entire matter of the race-track and the Debtor-Fried claims and counterclaims, to abide this Court's decisions in No. 26362 and No. 27000.

> "In view of the fact that the Supreme Court has granted certiorari in Weinstein v. Wolf [No. 26362], and Fried v. Margolis [No. 27000], we think it wise for the District Court to refrain from making any final determination concerning the proposed compromise until the Supreme Court announces its decision

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[36] *Bankruptcy Act*, § 27, 11 U. S. C. § 50, 52 Stat. 955 (1938); General Order 33, *f. Bankruptcy Act*, § 30. (*See* Wolf Brief *at* 65, n. 52.)

in these cases which could affect the ownership and control of the Debtor as well as *Fried's debts to the corporation.*

"We are entirely in accord with the purpose of the District Court to bring an end to this seemingly endless litigation. We think it best therefore to *remit* both appeals so that the District Court may finally dispose of the *entire set of claims and cross-claims* after the Supreme Court has spoken. To this end we *vacate* the judgment in Appeal No. 27248 and remand to the District Court for such action as it may deem proper. Reversed and remanded on both appeals." [37]

2. *Respondents' Indignation*: Weinstein and Fried affect indignation at Wolf's charges of fraud.

(a) In speaking of the Weinstein-Fried purchases of Nazareth stock during the proceedings, Weinstein denies that he "made a single cent of profit out of the purchase of stock." (Weinstein Brief *at* 11-12.) Of course: the stock has not been re-sold; and most was bought by Weinstein for Fried and others. (Wolf Brief *at* 8-9, 31-33.) Weinstein and Fried later admit a "small increase in the proportion of ownership" of Nazareth—on the stock they bought from Malakoff in 1951, and on the stock they bought from other stockholders during the Chapter X proceeding. (*Id.*; Fried Brief *at* 54, *adopted by* Weinstein Brief, *at* 2.) They merely deny the increase was a "windfall."

(b) In speaking of the District Court's order that Fried and Enterprises (his corporation) account for race-track rents belonging to the Debtor, Fried says the District Judge "found no diversion from the Debtor of any rental either by Fried or by Weinstein." (Fried Brief *at* 23.) By Fried's own figures, and pursuant to the District Court's limited

[37] *Wolf* v. *Nazareth Enterprises, Inc.*, 303 F. 2d 152, *at* 155 (2d Cir., 1962, *per* Smith, *J.*) (*emphasis supplied*).

order, Fried—with Weinstein's approval—took at least $23,996.77 in rents from the Debtor during the proceedings. They admit the taking. (Wolf Brief *at* 33-37, 186a-189a.) They merely deny the taking was a "diversion."

(c) Weinstein complains of Wolf's phrasing of the Questions Presented to the Court in No. 26362, particularly the references to fiduciaries' "diversions of the debtor's rents to *themselves* during the proceedings." (Wolf Brief, *at* 3, 50.) The word "themselves" is conclusory, like "diversions." To the injured Debtor (and to Wolf representatively), the distribution of the fruits among the wrongdoers is immaterial; it raises no question of law. Two fiduciaries who participate together, inseparably, actively, and deliberately, in a wrong to their principal, are liable for restitution *and* indemnity, jointly and severally.[38] The gravity of the wrongdoing is demonstrated by criminal liability as well as civil liability, willy-nilly personal profit to the accessory.[39]

Weinstein's indignation rises from his obdurate misconception of the law. He supposes that his forgoing a share of the Debtor's diverted property, excuses his diverting the Debtor's property to Fried. Wolf has never charged Weinstein with sharing with Fried in the diverted rents; for there is no such evidence. So Weinstein acknowledges. Wolf's Brief (33-37, 165) was intended to make that clear. But forgoing a share is only evidentiary, and is only relevant where participation is an issue of fact; "a showing of pecuniary interest [is] unnecessary to proof of a stake in the venture."[40] There is no such issue of fact here as to Weinstein's participation—as businessman and trustee, not as lawyer. Weinstein and Fried have admitted their diversions

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[38] *Mosser* v. *Darrow*, 341 U. S. 267 (1951, *per* Jackson, *J.*) (*quoted in Wolf* Brief *at* 181). *See also General Rubber Co.* v. *Benedict*, 215 N. Y. 18, 109 N. E. 96 (1915, *per* Cardozo, *J.*).

[39] *U. S.* v. *Knight*, 336 U. S. 505 (1949, *per* Douglas, *J.*) (*quoted in* Wolf Brief *at* 181).

[40] *U. S.* v. *Blazer*, 309 F. 2d 92, *at* 93 (2d Cir., 1962, *p. c.*).

of the race-track rents. An issue of law remains—evaded by the District Court and the Court of Appeals. Now Weinstein and Fried would have this Court evade the issue, too, by the sophistry of *res judicata* and mootness, by carping about words like "windfall" and "diversions" and "themselves", and by pleading "motive". "Conduct and purpose have a quality imprinted on them by the law."[41]

3. *Rehrig and Philip*: To account for their own misconduct, the respondents attack Rehrig and Philip (Wolf's principals).

(a) The respondents say that Philip bought stock while a director and officer of Nazareth. (Fried Brief *at* 25.) *That is not true.* Philip was elected a director and officer on August 4, 1958. Notwithstanding the unanimous vote of the stockholders (including Weinstein and Fried, voting their own shares and the proxies they had solicited), the respondents opposed Philip's (and Danciger's) election, and delayed confirmation by Judge Sugarman until June 14, 1960—almost 22 months later. (R. 226-7, 495-6.) Philip did not and could *not "become* an officer or director of the debtor • • • without the prior approval of the court."[42] Section 249 applies to a person "who at any time *after assuming to act* in such [fiduciary] capacity has purchased or sold • • • stock • • •."[43] Philip did *not* participate in Rehrig's purchase of Seymour Forman's stock in December of 1960—the sole purchase of Nazareth stock by anyone in the Rehrig Group after June 14, 1960, when Philip first became and acted as director and officer.

(b) The respondents say they were protecting Nazareth, by their stock purchases, from Rehrig's quest for control of

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[41] *Shapiro* v. *Wilgus*, 287 U. S. 348, *at* 357 (1932, *per* Cardozo, *J.*).

[42] *Bankruptcy Act*, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938) (*emphasis supplied*).

[43] *Bankruptcy Act*, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938) (*emphasis supplied*).

Nazareth and for a "preferential" lease. In the same breath, they deny their stock purchases were designed to perpetuate their own control of Nazareth and to assure Fried's lease (with rent reductions and diversions). (*See* R. 466-7; Wolf Brief *at* 10.) They presume their illegal stock purchases were indispensable to avoid a "preferential" lease to Rehrig. They ignore the Court's control of Rehrig's lease, as they ignored the Court's control of Fried's lease.[44] They ignore the standing of any stockholder to object to a "preferential" lease, as Wolf has objected to the preferences to Fried.[45]

They quote Rehrig's statement that he considered $10,000 per year a fair rent for the space he then occupied, rather than the $15,000 per year he was then paying, as proof of Rehrig's intent to rape the Debtor. (R. 445) Rehrig expressed a frank opinion of fair rental value of his *space*. Events have proved his opinion correct. After his lease expired on August 31, 1961, he remained a tenant at will, paying the same $15,000 per year. On May 13, 1962, fire damaged the grandstand building occupied by Rehrig and others, and destroyed the fixtures Rehrig had installed and paid for. The Debtor's repairs took months. Rehrig no longer needed to pay an excessive rent for his space to preserve his lost good-will and fixtures. He is no longer a tenant. The Debtor now has only the *space* to lease. Weinstein and Fried have solicited Rehrig's return at $15,000 per year—unsuccessfully. The space Rehrig had occupied has been vacant, and unproductive to the Debtor, since the fire last May.

(c) The *ad hominem* attacks on Rehrig and Philip are not only untrue, but immaterial and a smokescreen.

> "Nor can we sustain the contention that relief should be denied on the allegations that Young's

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[44] *Bankruptcy Act*, § 116(3); 11 U. S. C. § 516(3); 52 Stat. 885 (1938).

[45] *Bankruptcy Act*, § 206; 11 U. S. C. § 606; 52 Stat. 894 (1938).

[petitioner's] motive in bringing the [restitution] proceeding is an unworthy one. His petition sought relief for the benefit of all the stockholders. The rights of these stockholders are not to be ignored because of some motive attributable to Young." [46]

4. *Vitality of § 249*: The Sixth Circuit has joined the First, Second (except for *Nazareth*), Third, Fourth and Seventh Circuits in interpreting and applying § 249 in accordance with its plain meaning and its legislative history. *In re Inland Gas Corp.*, 309 F. 2d 176 (6th Cir., 1962, *per* Miller, *C. J.*). (*See* Wolf Brief *at* 142-4.)

5. *The Debtor as Tool and Meddler—Incapacity on Appeal*: The Debtor's name and moneys have been committed to a brief in support of Weinstein and Fried individually, in No. 26362 as well as No. 27000. (Debtor Brief *at* 61-64) Wolf's petitions in No. 26362 are representative. "The corporation can take no position in a derivative stockholder's suit which is fundamentally antagonistic to the claim asserted on its behalf." [47]

Dated: New York, New York
February 14, 1963

Respectfully submitted,

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[46] *Young* v. *Higbee Co.*, 324 U. S. 204, *at* 214 (1945, *per* Black, *J.*).

[47] *Carthage Paper Makers, Inc.* v. *Mutual Box Board Co.*, 159 N. Y. S. 2d 659, *at* 661 (Sup., Oneida, 1956, *per* Gorman, *J.*), *aff'd.* 3 A. D. 2d 640, 158 N. Y. S. 2d 790 (4th Dept., 1956, *memo*); *see Ballantine on Corporations* (1946), § 154.

ERRATA

(In Wolf Brief dated 11/26/62, filed 11/30/62)

Page xxvii, 6th citation: *Substitute* "Visitorial"

Page 8, line 21: *Add* "Ann Rosen" after Pollak

Page 29, 4th line from bottom: *Delete* "Weinstein"

Page 61, note 42, line 8: *Substitute* "served" for "saved"

Page 61, note 42, line 12: *Substitute* "No. 26962"

Page 66, 3rd par., line 6, 8th word: *Substitute* "misused"

Page 117, 2nd par., line 3: *Substitute* "pp. 21-23"

Page 119, line 6: *Substitute* "pp. 24-26"

Page 127, par. (i), line 7: *Substitute* "pp. 24-26"

Page 165, 1st par., line 11: *Substitute* "pp. 33-37"

Page 165, 1st par., line 17: *Substitute* "p. 33"

Page 170, line 10: *Substitute* "pp. 30-31"

Page 181, last line of quotations: *Substitute* "of forbidden acts, * * *." [309]

Page 221a, § 164, 1st line of text: *Italicize "or in article 6-A"*

Page 53, n. 32, *and* Page 199a: *Add* to citation of § 247: "Amended, P. L. 87-681, § 13; 76 Stat. 570 (1962)."

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Supreme Court of the United States

OCTOBER TERM, 1962.

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

v.

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., *et al.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION OF RESPONDENT JEROME FRIED FOR REHEARING.

HAROLD HARPER,
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Supreme Court of the United States

OCTOBER TERM, 1962.

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IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION OF RESPONDENT JEROME FRIED FOR REHEARING.

Respondent Jerome Fried presents his petition for a rehearing insofar as the decision of this Court on April 15, 1963, reversed the judgment of the Court of Appeals, held that this respondent is subject to §249 of the Bankruptcy Act, and that the Debtor is entitled to recoup from him all salary paid him for the past ten years.

I.

This Court has construed §249 of the Bankruptcy Act in such manner as to deprive respondent Fried of due process of law.

Fried maintains that the interpretation of §249 which the Court has reached overlooks an important constitutional limitation. Due process requires a statute to be sufficiently definite to apprise a person of ordinary intelli-

gence whether it applies to him. The Court holds that §249 may or may not apply to a "managing employee" of a Debtor-in-Possession, depending upon "in each case a careful examination of the nature of the particular applicant's activities, powers and responsibilities in connection with the reorganization" (p. 18). The decision thus requires a salaried employee of the Debtor-in-Possession (not a person designated in Article XIII) to make a choice of conduct without the benefit of an objective test. Whether he is in a "fiduciary capacity" within §249 will depend, under the Court's decision, upon whether the Bankruptcy Court subsequently says he is*, upon "a careful appraisal of the relevant facts" (p. 18). The statute, so interpreted, is void for vagueness.

Although phrased as a mere limitation upon the Bankruptcy Court in its allowance of compensation or reimbursement, §249 is actually a drastic penal statute. The Court recognizes the penal character of the section, by its quite natural references (pp. 22, 23) to "a violation of Section 249".

This statute bears no relation to such statutes as §16(b) of the Securities Exchange Act where the mandated loss of profits on the transaction bears a direct relationship to the forbidden dealing in securities. The penalty imposed by §249 is administered in the wholly unrelated field of compensation and reimbursement for expenses. The effect of the statute is the same as if it had forbidden the dealing in stock, and had imposed a fine, variable with the amount to which the applicant would have been entitled for his services, with forfeiture of all moneys laid out in the Debtor's behalf. While not technically a criminal statute**,

* Cf. *Connally* v. *General Const. Co.* (1926) 269 U. S. 385, 395.

** As will be seen, it is not essential that it be a criminal statute in order for the principle here invoked to apply. *Small Co.* v. *American Sugar Refining Co.* (1925) 267 U. S. 233, 239.

the severity of its sanction, recognized by the Court (p. 20) stamps it as a statute highly penal in character. Its impact has been called "tragic"*. Its "Draconian penalty" is highlighted by the impending result in this very case.

Fried had been employed prior to the filing of the petition for reorganization (R. 45), and his salary advanced to $200 per week from January 13, 1956 (R. 38-9). Despite the successful performance of his duties, which the Court concedes (p. 4), he must now return salary earned by the week over the last ten years. In substance, the Court has found Fried guilty of buying and selling a few shares of the Debtor's stock, and for that violation has fined him $86,500. Indeed, few criminal offenses call for so disproportionate a fine.

To meet the test of constitutionality, a statute of this character must set up a standard by which its applicability can be readily ascertained. So far as its reach is confined to the persons entitled to apply for an allowance under article (or sub-chapter) XIII, as the Court of Appeals held, its meaning is definite and certain. However, once the Court has chosen "a broader reading of Section 249" and has ventured "to transcend the bounds of the subchapter" (p. 13) in which §249 is found, it has embarked on an uncharted sea with only the words "fiduciary capacity" as a guide.

No words could be less precise in application. Every agent, in a sense, stands in a fiduciary relation**. The scrubwoman is a fiduciary as to her mop and pail.

To quote Mr. Justice Frankfurter in *SEC* v. *Chenery Corp.* (1943) 318 U. S. 80, 85-6:

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* *Third Avenue Transit Corporation* (S. D. N. Y. 1958) 159 F. Supp. 440, 443.

** Webster's Third New International Dictionary p. 846.

> "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry."

The Court's answer is a complete admission of the imprecision of the word "fiduciary".

> "In concluding as we do that an officer or a managing employee of a Debtor in possession may be a fiduciary for purposes of §249, we do not mean to suggest that one who holds such a position is *necessarily* within that section. That question requires in each case a careful examination of the nature of the particular applicant's activities, powers and responsibilities in connection with the reorganization. As to certain classes of participants—committee members and attorneys, for example—the very terms of §249 clearly make its sanctions applicable. As to other groups—salaried employees who take no part in the management of the Debtor, for instance—it may be equally clear that §249 was not meant to impose any ban on trading in the Debtor's stock. But in the case of an officer or managerial employee, the question whether the particular applicant is a 'fiduciary' under the statute is one which requires careful appraisal of the relevant facts" (p. 18).

The Court then proceeds to say that the District Court took evidence of respondent Fried's activities and responsibilities and concluded that he was a fiduciary, which finding this Court accepts (p. 19).

The constitutional question, however, is whether, with presumed knowledge of §249*, the employee, in considering a stock purchase, can be required to make "a careful appraisal of the relevant facts" under penalty of loss of

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* Of course, Fried never heard of the statute. Weinstein testified that he had not (R. 463). And that is undoubtedly the situation in most of the cases arising under this section, which has proved a veritable trap for the unwary.

his life's work and entire fortune if he guesses wrong as to what the Bankruptcy Court may find after it has made "a careful appraisal of the relevant facts".

The point becomes even clearer when the Court (footnote p. 18) argues for "a flexible assessment of particular powers and responsibilities rather than a rigid rule of thumb". Even so expert an authority on the Securities Exchange Act as the late Judge Jerome Frank was unable to decide as a matter of law whether a "vice-president" or "comptroller" was an "officer" within §16(b) of the Securities Exchange Act*. Yet the decision of this Court apparently requires this lay respondent, amidst his collection of rents, arrangement of advertising, and overseeing sanitation, at Nazareth (R. 485-9), to perform the much more difficult task of appraising his activities and determining at his peril whether they involve that degree of "fiduciary capacity" which will bring him under §249 as now defined.

To uphold such an application of §249 as constitutional will mean a departure by this Court from its uniform insistence that a statute commanding or prohibiting a course of conduct shall set up a standard comprehensible to, and capable of interpretation by the man in the street. A vague statute is a denial of due process.

Thus, this Court struck down a statute which made it unlawful wilfully "to make any unjust or unreasonable rate or charge in handling or dealing in or with any necessaries", *United States* v. *Cohen Grocery Co.* (1921), 255 U. S. 81, 89; a statute which imposed a penalty for failing to pay the "current rate of wages" in the "locality", *Connally* v. *General Const. Co.* (1926), 269 U. S. 385, 394-5; a statute which prohibited "production of crude oil * * * in

* *Colby* v. *Klune* (2 C. A. 1949) 178 F. 2d 872, 875.

such manner and under such conditions as to constitute waste", *Champlin Rfg. Co. v. Corporation Commission of Oklahoma* (1932), 286 U. S. 210, 242. In *Cramp* v. *Board of Public Instruction* (1961), 368 U. S. 278, in holding invalid a statute requiring an oath completely lacking in "terms susceptible of objective measurement" this Court, per Stewart, J., said (p. 287):

> "We think this case demonstrably falls within the compass of those decisions of the Court which hold that '* * * a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law.' *Connally* v. *General Construction Co.*, 269 U. S. 385, 391. 'No one may be required at peril of life, liberty or property to speculate as to the meaning of penal statutes. All are entitled to be informed as to what the State commands or forbids.' *Lanzetta* v. *New Jersey*, 306 U. S. 451, 453. 'Words which are vague and fluid * * * may be as much of a trap for the innocent as the ancient laws of Caligula.' *United States* v. *Cardiff*, 344 U. S. 174, 176."

In this instance the Court's interpretation has left the classification of the persons subject to the act shrouded in mist. No salaried employee can tell by any objective test whether or not he is in a "fiduciary capacity". The opinion as much as says that that employee of the Debtor-in-Possession is to be deemed in a "fiduciary capacity" within the meaning of §249 whom the Bankruptcy Court will subsequently determine to be a fiduciary upon "a careful appraisal of the relevant facts". No employee can constitutionally be required to determine whether he is included in the classification upon so completely subjective a test.

As was said by Sutherland, J., in *Connally, supra* (p. 395):

> "The result is that the application of the law depends not upon a word of fixed meaning in itself, or one made definite by statutory or judicial definition, or by the context or other legitimate aid to its construction, but upon the probably varying impressions of juries as to whether given areas are or are not to be included within particular localities. The constitutional guaranty of due process cannot be allowed to rest upon a support so equivocal."

§249 is severely penal, but the constitutional protection to which respondent Fried is entitled is by no means limited to criminal actions. In *Small Co.* v. *American Sugar Refining Co.* (1925) 267 U. S. 231, which raised in the context of a contract action the same question as *Cohen, supra*, the Court said (p. 239):

> "The defendant attempts to distinguish those cases because they were criminal prosecutions. But that is not an adequate distinction. The ground or principle of the decisions was not such as to be applicable only to criminal prosecutions. It was not the criminal penalty that was held invalid, but the exaction of obedience to a rule or standard which was so vague and indefinite as really to be no rule or standard at all. Any other means of exaction, such as declaring the transaction unlawful or stripping a participant of his rights under it, was equally within the principle of those cases. They have been so construed and applied by other courts in civil proceedings."

Thus, in this case respondent Fried cannot by a vague standard in a wholly subjective test be stripped of his rights to retain a salary meritoriously earned and paid him over the past ten years.

Conclusion.

Fried urges that to avoid an unconstitutional interpretation of §249 this Court, upon reconsideration, should affirm the Court of Appeals and hold that §249 applies only to the persons entitled to apply for an allowance under the other sections of Article XIII and that §249 does not apply to respondent Fried.

Dated: New York, N. Y.,
May 1, 1963.

Respectfully submitted,

HAROLD HARPER
VINCENT P. UIHLEIN
Counsel for Respondent
Jerome Fried.

Certificate of Counsel.

We, Harold Harper and Vincent P. Uihlein, counsel for the above-named respondent Jerome Fried, do hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay.

Harold Harper

Harold Harper

Vincent P. Uihlein

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Counsel for Respondent
Jerome Fried

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PETITION OF RESPONDENT ARNOLD A. WEINSTEIN FOR REHEARING

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION OF RESPONDENT ARNOLD A. WEINSTEIN FOR REHEARING

Respondent Weinstein prays for a rehearing as to so much of the decision of this Court on April 15, 1963, as held 249 of the Bankruptcy Act applicable to this Respondent and required him to return to the Debtor the salary he received over the past eight years.

I

In applying §249 of the Bankruptcy Act to respondent Weinstein, this Court did not follow the test for applicability of the statute as laid down in its decision and did not afford him due process of law.

The rule for determining the applicability of §249 was stated by this Court as follows:

> "The application of section 249 turns not upon the manner in which, or the time at which, payment is made, but rather upon the nature of the services and responsibilities which are being compensated" (p. 15).

Compensation to respondent Weinstein was ordered for the services he rendered and the responsibilities he undertook in the day to day business operations of the Debtor. This significant and relevant fact is not disputed. His services were not related to the court reorganization of the Debtor.

This Court has pointed out that an officer of a Debtor is not "*necessarily*" within section 249 and that "whether the particular applicant is a 'fiduciary' under the statute is a question which requires careful appraisal of the relevant facts" (p. 18). In this light, the arguments advanced by respondent Fried in his companion petition apply fully as well to respondent Weinstein. As interpreted and applied by this Court, §249 deprives respondent Weinstein of due process because it fails to provide a standard of certainty for its application to him since he may or may not be a "fiduciary" under the statute depending upon a "careful appraisal of the relevant facts" (p. 18). Respondent Weinstein is entitled to more than

this vague criterion before being penalized and dealt with in a manner which this Court concedes is severe and harsh (p. 20).

CONCLUSION

This Court should reconsider its determination and affirm the Court of Appeals by holding §249 of the Bankruptcy Act inapplicable to respondent Weinstein.

Dated: New York, N. Y.
May 1, 1963

Respectfully submitted,

ARNOLD A. WEINSTEIN,
Counsel pro se.

Certificate of Counsel

The undersigned, counsel *pro se*, does hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay.

ARNOLD A. WEINSTEIN,
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